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**State of California  
Office of Administrative Law**

In re:  
Board of Equalization

NOTICE OF APPROVAL OF REGULATORY  
ACTION

Regulatory Action:

Government Code Section 11349.3

Title 18, California Code of Regulations

OAL File No. 2010-0611-01 S

Adopt sections: 1698.5

Amend sections:

Repeal sections:

In this regulatory action, the Board of Equalization adopts a new regulation setting forth "Audit Procedures" for taxpayer audits under the Sales and Use Tax Law.

OAL approves this regulatory action pursuant to section 11349.3 of the Government Code. This regulatory action becomes effective on 8/18/2010.

Date: 7/19/2010

*Bradley J. Norris*

Bradley J. Norris  
Senior Staff Counsel

For: SUSAN LAPSLEY  
Director

Original: Ramon Hirsig  
Copy: Richard Bennion

**RECEIVED**

JUL 20 2010

by EXECUTIVE DIRECTOR'S OFFICE  
STATE BOARD OF EQUALIZATION

REC'D

JUL 21 2010

Board Proceed...



**OFFICE OF ADMINISTRATIVE LAW**

300 Capitol Mall, Suite 1250  
Sacramento, CA 95814  
(916) 323-6225 FAX (916) 323-6826



**SUSAN LAPSLEY**  
Director

**MEMORANDUM**

TO: Richard Bennion  
FROM: OAL Front Desk LW  
DATE: 7/20/2010  
RE: Return of Approved Rulemaking Materials  
OAL File No. 2010-0611-01S

OAL hereby returns this file your agency submitted for our review (OAL File No. 2010-0611-01S regarding Audit Procedures).

If this is an approved file, it contains a copy of the regulation(s) stamped "ENDORSED APPROVED" by the Office of Administrative Law and "ENDORSED FILED" by the Secretary of State. The effective date of an approved file is specified on the Form 400 (see item B.5). (Please Note: The 30<sup>th</sup> Day after filing with the Secretary of State is calculated from the date the Form 400 was stamped "ENDORSED FILED" by the Secretary of State.)

**DO NOT DISCARD OR DESTROY THIS FILE**

Due to its legal significance, you are required by law to preserve this rulemaking record. Government Code section 11347.3(d) requires that this record be available to the public and to the courts for possible later review. Government Code section 11347.3(e) further provides that "...no item contained in the file shall be removed, altered, or destroyed or otherwise disposed of." See also the Records Management Act (Government Code section 14740 et seq.) and the State Administrative Manual (SAM) section 1600 et seq.) regarding retention of your records.

If you decide not to keep the rulemaking records at your agency/office or at the State Records Center, you may transmit it to the State Archives with instructions that the Secretary of State shall not remove, alter, or destroy or otherwise dispose of any item contained in the file. See Government Code section 11347.3(f).

Enclosures

## NOTICE PUBLICATION/REGULATORY SUBMISSION

(See instructions on reverse)

STD. 400 (REV. 01-09)

OAL FILE NUMBERS	NOTICE FILE NUMBER	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
	Z-2010-0105-03	2010-0611-015	

For use by Office of Administrative Law (OAL) only

2010 JUN 11 AM 11:01

OFFICE OF  
ADMINISTRATIVE LAW

ENDORSED FILED  
IN THE OFFICE OF

2010 JUL 19 PM 1:21

Debra Bowen

DEBRA BOWEN  
SECRETARY OF STATE

NOTICE

REGULATIONS

AGENCY WITH RULEMAKING AUTHORITY

State Board of Equalization

AGENCY FILE NUMBER (If any)

**A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)**

1. SUBJECT OF NOTICE		TITLE(S)	FIRST SECTION AFFECTED	2. REQUESTED PUBLICATION DATE
3. NOTICE TYPE <input type="checkbox"/> Notice re Proposed <input type="checkbox"/> Regulatory Action <input type="checkbox"/> Other		4. AGENCY CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)
OAL USE ONLY	ACTION ON PROPOSED NOTICE <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn		NOTICE REGISTER NUMBER	PUBLICATION DATE
			2010, #3-2	1-15-2010

**B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)**

1a. SUBJECT OF REGULATION(S)		1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)	
Audit Procedures			
2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)			
SECTION(S) AFFECTED (List all section number(s) individually. Attach additional sheet if needed.)		ADOPT 1698.5 AMEND REPEAL	
TITLE(S) 18			
3. TYPE OF FILING			
<input checked="" type="checkbox"/> Regular Rulemaking (Gov. Code §11346) <input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4) <input type="checkbox"/> Emergency (Gov. Code, §11346.1(b)) <input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute. <input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1) <input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h)) <input type="checkbox"/> File & Print <input type="checkbox"/> Other (Specify) _____ <input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100) <input type="checkbox"/> Print Only			
4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)			
April 9, 2010 through May 25, 2010			
5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)			
<input checked="" type="checkbox"/> Effective 30th day after filing with Secretary of State <input type="checkbox"/> Effective on filing with Secretary of State <input type="checkbox"/> \$100 Changes Without Regulatory Effect <input type="checkbox"/> Effective other (Specify) _____			
6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY			
<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660) <input type="checkbox"/> Fair Political Practices Commission <input type="checkbox"/> State Fire Marshal <input type="checkbox"/> Other (Specify) _____			
7. CONTACT PERSON		TELEPHONE NUMBER	FAX NUMBER (Optional)
Richard E. Bennion		(916) 445-2130	(916) 324-3984
		E-MAIL ADDRESS (Optional)	
		rbennion@boe.ca.gov	

8. I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.

SIGNATURE OF AGENCY HEAD OR DESIGNEE	DATE
<i>Diane G. Olson</i>	June 9, 2010
TYPED NAME AND TITLE OF SIGNATORY	
Diane G. Olson, Chief, Board Proceedings Division	

For use by Office of Administrative Law (OAL) only

ENDORSED APPROVED

JUL 19 2010

Office of Administrative Law



**Final Text of  
California Code of Regulations,  
Title 18**

**Regulation 1698.5. Audit Procedures.**

**(a) Definitions.**

(1) Board. For the purposes of this regulation, "Board" refers to the Board of Equalization.

(2) Audit Engagement Letter. An "audit engagement letter" is correspondence used by Board staff to confirm the start of an audit or establish contact with the taxpayer.

(3) Pre-audit Conference. A "pre-audit conference" is a meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.

(4) Opening Conference. An "opening conference" is the first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.

(5) Status Conferences. "Status conferences" are meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.

(6) Exit Conference. An "exit conference" is the meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.

(7) Information/Document Request (IDR). An "Information/Document Request" (IDR) is correspondence Board staff may issue to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter is not an IDR.

(8) Audit Findings Presentation Sheet (AFPS). An "Audit Findings Presentation Sheet" (AFPS) is correspondence used to present Board staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to AFPSs.

(9) Records. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax

liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.

(10) Day. For the purposes of this regulation, "day" means calendar day.

**(b) General.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

**(4) Duty of Board Staff.**

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.



(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, the taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any

specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless the Board is prohibited by law from requiring the specific documents.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

**(c) Audits.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A taxpayer's request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant



to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives



for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.



2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code.



**M e m o r a n d u m**

**To :** Brad Norris  
Office of Administrative Law  
300 Capitol Mall, Suite 1250  
Sacramento, CA 95814

**From :** Richard Bennion  
Regulations Coordinator  
Board Proceedings Division, MIC: 80

**Subject :** *OAL File No. 2010-0611-01S*  
*Regulation 1698.5, Audit Procedures*

2010 JUL 15 AM 8:19

Date: July 15, 2010

OFFICE OF  
ADMINISTRATIVE LAW

The Office of Administrative Law (OAL) is authorized to make the following substitutions and corrections in connection with the above-referenced rulemaking file:

1. OAL is authorized to substitute the enclosed revised Final Regulation Text behind each copy of the Form 400 for filing with the Secretary of State.
2. OAL is authorized to correct the copies of the Form 400 for filing with the Secretary of State by adding the following beginning and ending dates of availability of modified regulations in Section B.4 of the form: "April 9, 2010 through May 25, 2010".
3. OAL is authorized to substitute the enclosed revised Final Statement of Reasons in Tab 1 of the rulemaking file.
4. OAL is authorized to substitute the enclosed revised Updated Informative Digest in Tab 2 of the rulemaking file.
5. OAL is authorized to substitute the enclosed revised Rulemaking File Index and Verification at the beginning of the rulemaking file.

If you have any questions or comments, please notify me at (916) 445-2130 or email at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov).

REB

# **SUMMARY OF REGULATORY ACTIONS**

## **REGULATIONS FILED WITH SECRETARY OF STATE**

This Summary of Regulatory Actions lists regulations filed with the Secretary of State on the dates indicated. Copies of the regulations may be obtained by contacting the agency or from the Secretary of State, Archives, 1020 O Street, Sacramento, CA 95814, (916) 653-7715. Please have the agency name and the date filed (see below) when making a request.

File# 2010-0603-02

**AIR RESOURCES BOARD**

**In-Use Off-Road Diesel Fueled Fleets**

This regulatory action deals with In-Use Off-Road Diesel-Fueled Fleets.

Title 13

California Code of Regulations

AMEND: 2449, 2449.1, 2449.2

Filed 07/16/2010

Effective 08/15/2010

Agency Contact: Amy Whiting (916) 322-6533

File# 2010-0611-01

**BOARD OF EQUALIZATION**

**Audit Procedures**

In this regulatory action, the Board of Equalization adopts a new regulation setting forth "Audit Procedures" for taxpayer audits under the Sales and Use Tax Law.

Title 18

California Code of Regulations

ADOPT: 1698.5

Filed 07/19/2010

Effective 08/18/2010

Agency Contact:

Richard Bennion (916) 445-2130

File# 2010-0624-02

**BOARD OF GUIDE DOGS FOR THE BLIND**

**Annual School Renewal Payment; Instruction Period**

The Board of Guide Dogs for the Blind (Board) submitted this timely certificate of compliance action to make permanent title 16, California Code of Regulations, sections 2262 and 2262.1, which were adopted in OAL file no. 2010-0211-02E, and to amend title 16, California Code of Regulations, section 2276. This action adopts new annual renewal fees to be paid by schools licensed by the Board, revises due dates for re-

newal payments, as specified, pursuant to board authority added to the Business & Professions Code sec. 7200.7 in SB 475 (ch. 51, Stats.2009), and further defines the standards to be followed by both schools and instructors licensed by the Board.

Title 16

California Code of Regulations

ADOPT: 2262.1 AMEND: 2262, 2276

Filed 07/21/2010

Effective 08/20/2010

Agency Contact:

Antonette Sorrick (916) 574-7825

File# 2010-0616-03

**BOARD OF OPTOMETRY**

**Repeal CCR section 1569 Scope of Practice**

In this regulatory action the Board of Optometry repeals the "Scope of Practice" regulation in Section 1569 of Title 16 of the California Code of Regulations because the regulation duplicates Business and Professions Code section 3041.

Title 16

California Code of Regulations

REPEAL: 1569

Filed 07/21/2010

Effective 08/20/2010

Agency Contact: Andrea Leiva (916) 575-7182

File# 2010-0713-01

**DEPARTMENT OF FOOD AND AGRICULTURE**

**European Grapevine Moth Interior Quarantine**

The Department of Food and Agriculture amended section 3437 in title 3 of the California Code of Regulations to expand the interior quarantine area in Sonoma County for European Grapevine Moth.

Title 3

California Code of Regulations

AMEND: 3437

Filed 07/20/2010

Effective 07/20/2010

Agency Contact: Susan McCarthy (916) 654-1017

File# 2010-0706-04

**DEPARTMENT OF FOOD AND AGRICULTURE**

**Light Brown Apple Moth Interior Quarantine**

The Department of Food & Agriculture (DFA) submitted this emergency action to amend title 3, California Code of Regulations, section 3434 by adding or changing quarantine areas for the Light Brown Apple Moth (LBAM), *Epiphyas postvittana*, in several counties due to recent LBAM detections in new areas of Alameda, Contra Costa, Los Angeles, Monterey, San Benito, San Joaquin, Santa Clara, Solano and Sonoma counties. A portion of the existing contiguous quarantine



Rulemaking File Index  
Title 18. Public Revenue  
Sales and Use Tax

Regulations 1698.5, *Audit Procedures*

1. *Final Statement of Reasons*
2. *Updated Informative Digest*
3. *Business Tax Committee, November 17, 2009, Item 1*
  - Agenda - Business Tax Committee, November 17, 2009
  - Formal Issue Paper Number 09-005
  - Exhibit 1, Revenue Estimate
  - Exhibit 2, Text for Regulation 1698.5
  - Exhibit 3, Draft Information/Document Request (IDR) Form
  - Exhibit 4, Draft Audit Findings Presentation Sheet (APFS) Form
  - Exhibit 5, Audit Process Flow Chart
  - Minutes
4. *Reporter's Transcript Business Taxes Committee, November 17, 2009*
5. *Estimate of Cost or Savings, January 14, 2010*
6. *Economic and Fiscal Impact Statements, Regulation 1698.5, January 5, 2010*
7. *Notice of Publications*
  - Form 400 submitted to OAL January 5, 2010
  - Notice and Proposed Text of Regulation 1698.5
  - Email sent to Interested Parties, January 15, 2010
  - CA Regulatory Notice Register 2010, Volume No. 3-Z
8. *Notice to Interested Parties, January 15, 2010*

The following items are exhibited:

  - Notice of Hearing
  - Initial Statement of Reasons
  - Proposed Text of Regulation 1698.5
  - Regulation History
9. *Correction of Notice of Publications*
  - Correction Notice
  - CA Regulatory Notice Register 2010, Volume No. 4-Z
10. *Correction Notice to Interested Parties, January 20, 2010*
11. *Todd C. Gilman, Taxpayers' Rights Comment*
12. *Statement of Compliance*

13. *Reporter's Transcript, Item F1, Public Hearing, March 23, 2010*
14. *Minutes, March 23, 2010, and Exhibits*
15. *Revised Estimate of Cost/ Savings, April 27, 2010*
16. *Revised Economic and Fiscal Impact Statement, April 27, 2010*
17. *15 Day Letter*

The following items were attached to the Letter:

- 15 Day Letter to interested parties, April 9, 2010
  - Proposed revised text of Regulation 1698.5
18. *Statement of Compliance*
  19. *Minutes of the State Board of Equalization's Meeting, Chief Counsel Matters, Rulemaking, May 26, 2010, Item J1. The following items are exhibited:*
    - 15 Day Notice to interested parties, April 9, 2010
    - Proposed revised text of Regulation 1698.5
  20. *Reporter's Transcript Chief Counsel Matters, Rulemaking, May 26, 2010, Item J1*

## VERIFICATION

I, Richard E. Bennion, Regulations Coordinator of the State Board of Equalization, state that the rulemaking file of which the contents as listed in the index is complete, and that the record was initially closed on June 9, 2010. The file was reopened on July 14, 2010 for changes without regulatory effect and document revision requested by OAL and the file was closed on July 15, 2010. The attached copy is complete.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

July 15, 2010



Richard E. Bennion  
Regulations Coordinator  
State Board of Equalization



**Final Statement of Reasons for  
Proposed Adoption of California Code of Regulations,  
Title 18, Section 1698.5, Audit Procedures**

**Update of Information in the Initial Statement of Reasons**

The factual basis, specific purpose, and necessity for the proposed adoption of the original text of California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*, are the same as provided in the Initial Statement of Reasons.

However, during the March 23, 2010, public hearing, the Board made sufficiently related changes to the original text of proposed Regulation 1698.5 after considering a memorandum from the Board's Chief Counsel dated March 10, 2010. This memorandum was identified and made available to the public as part of footnote 2 to the fifteen day letter dated April 9, 2010, which describes the sufficiently related changes in detail. The Board subsequently adopted the text of proposed Regulation 1698.5 with the sufficiently related changes at a public meeting on May 26, 2010.

The Board deleted the phrase "which is used to confirm the start of an audit or establish contact with the taxpayer" from subdivision (a)(6) of the original text of proposed Regulation 1698.5; added a new subdivision (a)(2) to the original text of proposed Regulation 1698.5 to define the term "audit engagement letter" for purposes of the entire regulation; and renumbered the other paragraphs in subdivision (a) accordingly. The specific purposes for these sufficiently related changes are to clarify the definition of Information/Document Request and create a separate definition for "Audit Engagement Letter." The Board determined that these changes are necessary in order to help taxpayers identify and distinguish the two different types of correspondence and avoid potential confusion.

The Board changed the definitions for "Information/Document Request" and "Audit Findings Presentation Sheet" in subdivision (a) of the original text of proposed Regulation 1698.5. The specific purposes for these sufficiently related changes are to clarify that these documents are merely audit correspondence used to request information and documents from taxpayers and present audit findings to taxpayers, respectively; and further clarify that the Board is not trying to incorporate the correspondence or any additional regulatory requirements set forth therein into Regulation 1698.5 by reference pursuant to California Code of Regulations, title 1, section 20. The Board determined that these changes are necessary to prevent the text of Regulation 1698.5 from creating an inference that these two types of correspondence are forms that have been incorporated into the regulation by reference pursuant to California Code of Regulations, title 1, section 20, or the inference that these two types of correspondence impose additional regulatory requirements on taxpayers.

The Board deleted the phrase "and provide adequate resources to do so" from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B). The specific purpose for this



sufficiently related change is to clarify that taxpayers are not legally required to devote adequate resources to their audits. The Board determined that this change is necessary because the Board does not have statutory authority to require taxpayers to devote adequate resources to their audits.

The Board also changed the language in the original text of proposed Regulation 1698.5, subdivision (b)(5)(C) to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by any applicable law, not just a “federal” law, from requiring that taxpayers do so. The specific purpose for these sufficiently related changes is to clarify that Board staff is prohibited from requiring that taxpayers provide documents when the Board is prohibited from requiring the production of such documents under any applicable law, including both state and federal law. The Board determined that these changes are necessary to ensure that Board staff complies with all applicable laws.

In addition, the Board discussed the necessity for proposed Regulation 1698.5 during the March 23, 2010, public hearing and the Board Chair indicated that the regulation is necessary to clearly establish taxpayers’ and Board staff’s responsibilities and duties during the audit process in order to ensure that Board staff completes audits in a timely and efficient manner with due regard to each taxpayer’s rights, and to help taxpayers better understand and avoid confusion regarding the Board’s audit process, as explained in the fifteen day letter dated April 9, 2010.

Furthermore, the Board notes that proposed Regulation 1698.5 is substantially similar to Regulation 19032, *Audit Procedures*, which was adopted by the Franchise Tax Board in 2003. Regulation 19032 has the same general purpose as proposed Regulation 1698.5, to prescribe procedures for conducting tax audits. And, proposed Regulation 1698.5 is just as necessary for the administration and enforcement of the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), as Regulation 19032 is necessary for the administration and enforcement of the franchise and income tax laws.

Finally, the Board made additional non-substantial changes to proposed Regulation 1698.5 during the Office of Administrative Law’s review of the rulemaking file. First, the Board reformatted the definitions in Regulation 1698.5, subdivision (a)(2) through (8) in order to make the definitions’ formatting consistent with the formatting of the definitions in subdivision (a)(1), (9), and (10), and add additional clarity. Second, the Board added the word “taxpayer’s” to the second sentence in Regulation 1698.5, subdivision (c)(1) to clarify that the sentence refers to a taxpayer’s request to conduct the taxpayer’s audit at a different location. Third, the Board deleted the citation to “California Code of Regulations, title 18, section 1698” from the reference note for Regulation 1698.5 because California regulations are not one of the types of references listed in California Code of Regulations, title 1, section 14, subdivision (b), which implements, interprets, and makes specific the term “reference” as used in Government Code section 11349, subdivision (e).

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting Regulation 1698.5 with the sufficiently related changes that was not identified in the Initial Statement of Reasons, or which was otherwise not identified or made available for public review prior to the close of the original public comment period, or was not identified and made available for public review and comment in the fifteen day letter dated April 9, 2010.

The Board did not reject any reasonable alternatives to the original proposed text of Regulation 1698.5 or any alternatives that would lessen the adverse economic impact on small businesses. No alternative language was presented to the Board for consideration other than the grammatical and sufficiently related changes recommended by Board staff in the memorandum from the Board's Chief Counsel dated March 10, 2010, and discussed by Board staff during the March 23, 2010, public hearing.

The Board has determined that the adoption of proposed Regulation 1698.5 will not have a significant adverse economic impact on business.

#### **No Mandate on Local Agencies or School Districts**

The Board has determined that the adoption of proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts.

#### **Response to Public Comment**

On March 23, 2010, the Board held a public hearing on the proposed adoption of Regulation 1698.5. No interested parties appeared at the public hearing and no written comments were received from interested parties. During the public meeting on May 26, 2010, the Board adopted proposed Regulation 1698.5 with the sufficiently related changes described in the fifteen day letter dated April 9, 2010. No interested parties appeared at the public meeting to comment upon the proposed adoption of Regulation 1698.5 with the sufficiently related changes and no written comments were received from interested parties regarding the proposed adoption of Regulation 1698.5 with the sufficiently related changes.

#### **Alternatives Considered**

By its motion, the Board determined that no alternative to proposed Regulation 1698.5 would be more effective in carrying out the purposes for which the regulation is proposed or would be as effective and less burdensome to affected private persons than the proposed regulation.

#### **No Federal Mandate**

The adoption of Regulation 1698.5 is not mandated by federal statutes or regulations.



**Updated Informative Digest for  
Proposed Adoption of California Code of Regulations,  
Title 18, Section 1698.5, Audit Procedures**

The Board of Equalization held a public hearing regarding the proposed adoption of California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*, on March 23, 2010. No interested parties asked to speak at the public hearing or submitted written comments regarding the proposed regulation. However, the Board considered grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5 described in a memorandum from the Board's Chief Counsel dated March 10, 2010, and directed staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5 described in the fifteen day letter dated April 9, 2010.

During the public meeting on May 26, 2010, the Board considered and adopted the original text of proposed Regulation 1698.5 with the grammatical and sufficiently related changes described in the fifteen day letter. No interested parties submitted written comments regarding the proposed adoption of Regulation 1698.5 or made oral comments to the Board regarding its adoption.

There have not been any changes to the applicable laws or the general effect of the adoption of Regulation 1698.5 described in the Informative Digest included in the Notice of Proposed Regulatory Action. Proposed Regulation 1698.5 still prescribes the procedures for conducting sales and use tax audits and provides guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process. However, the sufficiently related changes to the original text of Regulation 1698.5 did make two related changes to the effect of the regulation, which are described in more detail below.

Furthermore, Regulation 1698.5 is substantially similar to and has a similar effect as Regulation 19032, *Audit Procedures*, which was adopted by the Franchise Tax Board in 2003.

**Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.



The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits. However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

### **Proposed Regulation (Prior to Sufficiently Related Changes)**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits and requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs).



In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.

### **Sufficiently Related Changes**

The Board deleted the phrase "which is used to confirm the start of an audit or establish contact with the taxpayer" from subdivision (a)(6) of the original text of proposed Regulation 1698.5; added a new subdivision (a)(2) to the original text of proposed Regulation 1698.5 to define the term "Audit Engagement Letter" for purposes of the entire regulation; and renumbered the other paragraphs in subdivision (a) accordingly. These sufficiently related changes did not change the regulation's effect. The changes merely clarified the definition of Information/Document Request and created a separate definition for "Audit Engagement Letter" in order to help taxpayers identify and distinguish the two different types of correspondence.

The Board changed the definitions for "Information/Document Request" and "Audit Findings Presentation Sheet" in subdivision (a) of the original text of proposed Regulation 1698.5 to clarify that these documents are merely audit correspondence used to request information and documents from taxpayers and present audit findings to taxpayers, respectively; and further clarify that the Board is not trying to incorporate the correspondence or any additional regulatory requirements set forth therein into Regulation 1698.5 by reference pursuant to California Code of Regulations, title 1, section 20. These sufficiently related changes did not change the regulation's effect. They merely clarified the definitions for Information/Document Request and Audit Findings Presentation Sheet so that the text of Regulation 1698.5 does not create an

inference that these two types of correspondence are forms that have been incorporated into the regulation by reference pursuant to *California Code of Regulations*, title 1, section 20, and does not create an inference that these two types of correspondence impose additional regulatory requirements on taxpayers.

The Board deleted the phrase “and provide adequate resources to do so” from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B) because the Board does not have statutory authority to require taxpayers to devote adequate resources to their audits. Therefore, this change did result in a change to the effect of Regulation 1698.5 because the regulation will no longer require taxpayers to devote adequate resources to their audits.

Finally, the Board revised the language in the original text of proposed Regulation 1698.5, subdivision (b)(5)(C) to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by any applicable law, not just a “federal” law, from requiring that taxpayers do so. Therefore, this sufficiently related change did result in a change to the effect of Regulation 1698.5 because the regulation will now prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited from requiring the production of such documents under any applicable law, including both state and federal law.

#### **Non-Substantial Changes**

The Board also made additional non-substantial changes to proposed Regulation 1698.5 during the Office of Administrative Law’s review of the rulemaking file. First, the Board reformatted the definitions in Regulation 1698.5, subdivision (a)(2) through (8) in order to make the definitions’ formatting consistent with the formatting of the definitions in subdivision (a)(1), (9), and (10), and add additional clarity. Second, the Board added the word “taxpayer’s” to the second sentence in Regulation 1698.5, subdivision (c)(1) to clarify that the sentence refers to a taxpayer’s request to conduct the taxpayer’s audit at a different location. Third, the Board deleted the citation to “California Code of Regulations, title 18, section 1698” from the reference note for Regulation 1698.5 because California regulations are not one of the types of references listed in California Code of Regulations, title 1, section 14, subdivision (b), which implements, interprets, and makes specific the term “reference” as used in Government Code section 11349, subdivision (e).



**AGENDA — November 17, 2009 Business Taxes Committee Meeting**  
**Proposed regulation for audit procedures in general**

Formal Issue Paper Number 09-005

<b>Action 1 — Proposed Regulation 1698.5, <i>Audit Procedures</i></b>  Issue Paper Alternative 1 – Staff Recommendation Agenda, page 2    Issue Paper Alternative 2 – No regulation	Approve and authorize publication of proposed Regulation 1698.5.  <div style="text-align: center;">OR</div> Do not approve proposed Regulation 1698.5.
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**AGENDA — November 17, 2009 Business Taxes Committee Meeting**  
**Proposed regulation for audit procedures in general**

Formal Issue Paper Number 09-005

**Action 1 —  
Proposed  
Regulation  
1698.5**

**Regulation 1698.5. AUDIT PROCEDURES**

**(a) DEFINITIONS.**

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (9) DAY. For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for



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**Proposed regulation for audit procedures in general**

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appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

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**Proposed regulation for audit procedures in general**

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(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(8) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue



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and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

**(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to



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attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Claims for Refund. Taxpayers or their representatives should present claims for refund at the beginning of the audit. A claim for refund that is presented near the conclusion of the audit may be addressed separately so as not to delay the timely completion of the current audit.

(8) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(9) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.



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**Proposed regulation for audit procedures in general**

(10) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(11) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to

**AGENDA — November 17, 2009 Business Taxes Committee Meeting**  
**Proposed regulation for audit procedures in general**

the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(12) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.



Issue Paper Number 09-005



BOARD OF EQUALIZATION  
**KEY AGENCY ISSUE**

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services and Administrative Efficiency Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Other

## Proposed regulation for audit procedures in general

### I. Issue

Should a new regulation be adopted that would outline general audit procedures?

### II. Alternative 1 - Staff Recommendation

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given our limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board of Equalization staff.

### III. Other Alternative Considered

Do not approve proposed Regulation 1698.5. The following interested parties submitted comments recommending the Board not approve the proposed regulation: Mr. Michael Wang, Western States Petroleum Association; Mr. Joseph Vinatieri, Bewley, Lassleben & Miller; Mr. Dan Davis, Associated Sales Tax Consultants; Mr. Norman Jung, BDO Seldman; Ms. Michele Pielsticker, California Taxpayers' Association, California Bankers Association, California Chamber of Commerce, California Manufacturers and Technology Association, and TechAmerica; Ms. Katherine Neggers, General Electric Company; Mr. Dennis Brown, Equipment Leasing and Finance Association; Ms. Pamela Sederholm, American Automotive Leasing Association; Mr. Randall McCathren, Association of Consumer Vehicle Lessors; and Ms. Jana Leslie, Council on State Taxation.

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**IV. Background**

Revenue and Taxation Code sections 7053 and 7054 provide that California sellers, retailers, and persons purchasing property for storage, use, or consumption in California are required to maintain records and provide those records to the Board for verification of amounts required to be paid to the Board. The objective of a sales and use tax audit is to determine, with the least possible expenditure of time, the accuracy of any return made or the amount required to be paid. Although the Board's audit manual provides detailed procedures and techniques for verifying amounts reported on sales and use tax returns, the Board does not have a regulation on audit procedures.

Staff met with interested parties on February 3, 5 and 10, 2009; June 2, 2009; and August 4 and 6, 2009, to discuss proposed Regulation 1698.5. The issue is scheduled for discussion at the November 17, 2009, meeting of the Business Taxes Committee.

**V. Discussion**

Because sales and use taxes are self-assessed by taxpayers, the Board's audit program is essential to ensure that the tax is being enforced uniformly, to deter tax evasion and carelessness in self-assessments, and to promote accuracy in self-assessments with respect to the interpretation of the law. Staff and interested parties have worked together to address concerns and clarify the proposed regulatory language; however, many issues remain unresolved.

**Need for the proposed regulation.** Interested parties commented that staff has not demonstrated a need for the regulation, and that the imprecise nature of the proposed language is out of place in a regulation. Providing that "in general, a procedure will be x" is vague and likely will lead to disputes with taxpayers over how to interpret terms, ultimately resulting in litigation. They conclude that while some degree of flexibility is desirable, a regulation has the force and effect of law, and such flexibility is better placed in the Board's audit manual.

Staff disagrees. Although the Board's audit manual is available to the public, it is primarily an advisory resource providing guidance to Board staff. Audit procedures formalized in a regulation are clearly intended to guide Board staff and taxpayers. Regulations are also more accessible to the public. Because the regulation provides consistent definitions and procedures, people with various levels of expertise can navigate through the sometimes complex audit process.

Staff recognizes that all audits are different and intentionally drafted its proposal so that auditors use their judgment in applying the regulation to the facts and circumstances of any particular audit. Auditors have the duty to exercise professional judgment and expertise throughout the audit process and will continue to carry out that duty in applying the provisions of the regulation. Auditors currently decide how to test reported transactions, the materiality of an audit area, and how much time to allow taxpayers to provide records. An overly prescriptive regulation would undesirably restrict both taxpayers and staff. Staff believes the proposed regulation is necessary to improve audit efficiency and believes this improvement will accelerate revenue collection.

**Two-year timeframe for completing audits.** Board staff completes most audits within a few months; however, complicated audits can take longer. Staff believes that by working cooperatively with taxpayers, most audits can be completed in two years. Staff has included this goal in subdivision (c)(8):



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“ . . . To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted. . . .”

The two-year timeframe does not include the pre-audit conference time for staff and the taxpayer to discuss the availability and production of records, including electronic records.

Interested parties commented that it is unreasonable to expect large audits to be completed in two years. The only way for many companies to achieve a two-year completion would be to dedicate an exorbitant amount of state and taxpayer resources. These costs would outweigh any benefit from an expedited audit of a taxpayer. Interested parties further commented that field auditors trying to meet the two-year timeframe probably would not allow taxpayers additional time to provide records to resolve audit issues in the field and as a result, there will likely be an increase in audit appeals.

Staff believes that with the proposed improvements to audit processes, such as pre-audit conferences and the inclusion of timeframes for both taxpayers and staff in the Information/Document Request and Audit Findings Presentation Sheet processes, the goal of completing an audit within two years is feasible. However, in recognition that not all audits will meet this standard, staff's proposed regulatory language clearly shows that the two-year timeframe is a goal and not a requirement.

**Concurrent audits.** Staff believes in most audit situations it is beneficial to proceed with a subsequent audit even though the prior audit is still in process or under appeal. Accordingly, subdivision (c)(4) provides in the second paragraph:

“Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal or a prior audit currently in the Board's appeal process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of an appeal.”

Interested parties commented that it is unreasonable to conduct an audit when a significant amount of time and effort might be saved resulting from the outcome of an appeal or audit in progress. Many times when an older audit is concluded, the taxpayer and the auditor will agree to apply the results of the audit to future periods. This practice saves resources for both the taxpayer and the state. In other cases, the audit involves a significant legal issue that the taxpayer believes can be resolved by the Appeals Division or the Board. Again, the effect of proceeding with the subsequent audit will be to push through an audit even though with a reasonable wait period, the subsequent audit could be resolved without a substantial outlay of time and money on both the part of the state and the taxpayer.

Staff believes that it is generally better not to delay audits, as it is more difficult for taxpayers to provide older records (changes in the taxpayer's recordkeeping software, accounting staff, and record storage systems are more likely as time passes). It is also more difficult for taxpayers to support non-taxable transactions with third parties the longer an audit is delayed. For example, if a taxpayer sends letters to customers to support claimed resale transactions, it is generally easier if the transactions are recent.



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Proceeding with a subsequent audit also means that areas of the audit not under contention can be verified as accurately reported or determined if underreported. The taxpayer will also know the amount of the possible liability for audit areas under dispute. In this way, taxpayers can pay the liability they agree with and decide if they want to pre-pay any disputed liability to stop interest from accruing. This may be particularly important in appeal cases where it may take several months or even years to resolve the case.

Staff agrees that audits can require a substantial amount of taxpayer resources, and believes that starting the subsequent audit field work with areas unaffected by the outcome of the prior audit or appeal may alleviate some of interested parties concerns, as the issue may be resolved before the subsequent audit is completed. Staff would also like to note that accounts are not routinely assigned for subsequent audits; accounts are selected and assigned after consideration of many factors. When reporting errors are found in an audit, the account is generally selected for the next audit period to ensure that those errors were corrected. If an error still exists, the auditor may be able to use a percentage of error developed from the prior audit to estimate liability in the current audit. Procedures for the use of prior audit percentages are included in Audit Manual section 0405.33. Separate from the proposed regulation issue, the Sales and Use Tax Department will issue a policy memo to remind and encourage audit staff to use prior audit percentages whenever the situation qualifies and the taxpayer agrees.

Although interested parties commented that beginning subdivision (c)(4) with the word “generally” could result in inconsistent application and excessive auditor discretion, staff added the term so that the provision to not hold a subsequent audit in abeyance is not absolute. That is, staff could hold the start of a subsequent audit when both the taxpayer and staff agree. However, staff believes the decision whether to hold or proceed with a subsequent audit is the responsibility of Board audit staff.

**Information/Document Request (IDR) process.** Proposed Regulation 1698.5 includes an IDR process to be used when the taxpayer is unresponsive to the auditor’s verbal requests for records. The auditor has the discretion to determine response times for verbal requests. Currently under development, IDRs are Board forms used to request single or multiple documents from the taxpayer (see Exhibit 3). The IDR process includes sending an initial IDR, a second IDR, and a formal notice and demand to furnish information. This process is similar to the record request process included in current Audit Manual section 0401.25, except that it includes timeframes for IDR responses. Staff believes incorporating these timeframes formalizes the existing process and will improve the consistency in how records are requested. The IDR process allows taxpayers the following number of days to provide records (unless a period of the audit will expire under the statute of limitations):

- 30 days for the first IDR,
- 15 days for the second IDR, and
- 15 days for the formal notice and demand before staff may issue a subpoena for records or issue a determination based on an estimate.

The process also provides that any response other than full compliance with the initial IDR will be reviewed by the District Principal Auditor who will determine the course of action to be taken in response to any issues raised by the taxpayer. When an auditor receives records in response to an IDR, the auditor will have 30 days to notify the taxpayer whether the documents provided are sufficient or if additional information is needed.



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Some interested parties commented that a 30-day response time for an IDR is not reasonable. Much of the audit fieldwork is centered on reviewing thousands of transactions that have occurred during the audit period – even on a statistical sample basis there are numerous transactions to be reviewed and documents to support the transactions. The proposed process ignores the detailed nature of a sales and use tax audit.

Staff notes that the IDR process is only used when the taxpayer does not respond to verbal requests for records. Auditors and taxpayers are expected to work cooperatively to allow the taxpayer sufficient time to provide records before the IDR process begins.

**Audit Findings Presentation Sheet (AFPS) Process.** Also under development, AFPSs are Board forms used to present staff's findings for each area of the audit as it is completed (see Exhibit 4). The audit working paper lead and subsidiary schedules will be attached to AFPSs; comments on the AFPS forms do not take the place of verification comments on audit working papers. The purpose of the AFPS process is to keep taxpayers informed about, and document, the status of the audit as it proceeds.

Taxpayers will generally have 30 days from the date the AFPS is provided to indicate whether they agree or disagree with the proposed findings and to provide additional information to rebut the findings if they disagree. The proposed regulation explains that a taxpayer's agreement with the audit findings on the AFPS does not preclude the taxpayer from protesting or appealing the issues at a later date. As a general rule, within 30 days of receiving the additional information, the auditor will notify the taxpayer if an adjustment to the audit is warranted based on the information provided.

Interested parties commented that the AFPS provision seems to require the taxpayer to formulate a defense during the course of the audit which might impact a subsequent appeal of the audit after its closure. Taxpayers need time to consult with legal counsel and gather necessary information before formulating a position with respect to certain portions of the audit. The AFPS also appears to be duplicative of the audit working papers, and seems to conflict with the taxpayer's right to respond to the total audit determination at the close of the audit.

Staff believes that combined with routine audit status conferences, the AFPS process will keep taxpayers informed and document the status of their audit. By making taxpayers aware of possible liability during the audit rather than at the end of the audit, taxpayers will have more time to provide information that rebuts the audit findings. Taxpayers are also provided an earlier time to pre-pay audit liabilities they do not dispute.

**Duty of Board staff to request information.** Auditors must request records in order to ascertain whether the correct amount of tax was reported. Interested parties expressed concerns that earlier versions of the proposed regulation did not protect taxpayers from overreaching auditors, including auditors who want direct access to the taxpayer's computer system. Interested parties also recommended that the proposed regulation specifically address the issue of providing electronic records in the format determined by the Board.

To address these concerns, staff added a definition of "records" [subdivision (a)(8)] referring to the records required in Regulation 1698, *Records*. Staff also revised subdivision (b)(4)(C) to refer to Regulation 1698 and to explain that staff will work with the taxpayer to resolve difficulties the taxpayer may have when responding to Board information requests, including the use of satisfactory alternative sources of information. Staff does not believe a specific provision is needed in proposed Regulation 1698.5 for electronic records as Regulation 1698 already addresses machine-sensible (electronic) records. With regard to direct access to a taxpayer's computer system, staff added



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subdivision (b)(4)(D) to provide that staff will not directly access a taxpayer's computer system if the taxpayer objects to such access except in the case of a search warrant.

**Duty of taxpayer to make records available for photocopying or scanning.** Subdivision (b)(5)(C) provides that the Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transactions. Staff included this provision since including copies of questioned invoices, resale certificates, contracts, etc. in the audit working papers can be useful in showing why a nontaxable transaction was disallowed.

Interested parties explained that some taxpayers may have legitimate business policies to forbid any scanned or photocopied documents from leaving the business premises. These reasons could include contractual obligations or national security obligations imposed by federal agencies. In response to this concern, staff revised its proposed language to provide that taxpayers may be required to make records available for photocopying or scanning, unless otherwise prohibited by federal law. Staff notes, however, that the taxpayer may still have to make these records available for staff's review in order to support a non-taxable transaction.

**Duty of taxpayers to provide adequate resources.** Subdivision (b)(5)(B) provides that taxpayers have the duty to provide adequate resources in order to adhere to the timelines provided in the audit plan. This provision mirrors subdivision (b)(4)(F), which provides that Board staff has the duty to provide adequate resources to adhere to the timelines in the audit plan. Staff added these provisions to show that audits are a cooperative effort requiring resources from Board staff and taxpayers.

Some interested parties commented that the Revenue and Taxation Code requires taxpayers to make records available for review, not that taxpayers make employees available to help auditors complete their assignments on time. Outside of the customary communications between taxpayers or representatives and auditors that have always been part of the audit process, the Board is not (and should not be) empowered to require a taxpayer to commit staff to an audit for any purpose. A government agency does not have the authority to tell a taxpayer how many employees the taxpayer's tax department should have and what they should be working on.

Again, staff believes audits are cooperative efforts and the regulation should reflect that both staff and taxpayers have the duty to meet the agreed upon timeframes.

**Location of audits.** Subdivision (c)(1) provides that audits generally take place where the taxpayer's books and records are maintained, usually the taxpayer's place of business. Taxpayers can request that the audit take place at a different location, however, it is the taxpayer's responsibility to provide all requested records at that location. The subdivision explains that reasonable requests to move an audit to another location will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location. Staff included this provision to prevent unnecessary delays in the audit or situations where requested changes in locations may only impede the progress of an audit.

Some interested parties expressed concern that the proposed provisions are a step backward from the existing practice which allows taxpayers to determine the location of an audit if adequate books and records are provided to Board staff at that location. The provisions give too much discretion to Board staff to deny taxpayers the ability to undergo an audit at the taxpayer's most convenient location.



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Staff disagrees, as the reasons for not granting the request are explained and narrow in scope.

**Audit plan.** Subdivision (c)(8) provides that an audit plan is required on all audits and that the audit plan document the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. The audit plan is to be discussed with the taxpayer and a copy provided at the beginning of the audit. The plan should be signed by the auditor and the taxpayer to show a commitment by both parties that the audit will be conducted in the manner discussed. Changes to the plan may occur if the auditor discovers a previously unknown area requiring review, or determines that a taxpayer needs additional time to provide records or information about questioned transactions. If the original audit plan is amended, the auditor will provide the taxpayer with a copy of the amended plan.

Some interested parties contend that it should be made clear that the audit plan is not binding and the taxpayer is not compelled to agree with it. The use of the word "commitment" causes concern that the audit plan may be used to force a taxpayer into an unfavorable audit methodology. Taxpayers should not be compelled to agree with the plan or proposed methodology; a signature should indicate only that the taxpayer has read and understands the plan.

Again, staff believes that having taxpayers sign the audit plan shows that audits are a cooperative effort between Board staff and taxpayers.

**Waiver of Limitation.** In response to interested party comments about the waiver of limitation approval process, staff added subdivision (b)(3) to explain the purpose of a waiver of limitation and when auditors should request the taxpayer sign a waiver. The subdivision includes staff's current policy requiring that supervisory approval of the circumstances which necessitated the request for the waiver is documented in the audit before the waiver is presented to the taxpayer for signature. In further response to interested party concerns, staff added a new policy requiring approval by the District Principal Auditor be documented in the audit before the waiver is presented to the taxpayer for signature, if the extension of the statute of limitations totals two years or more.

**Third party information.** Interested parties commented that they want to ensure that auditors do not apply the proposed regulation to third parties who may hold information relevant to the audit of another taxpayer, but who are not themselves under audit or examination.

Staff's proposed regulation explains general audit procedures when a taxpayer is under audit. However, staff does not believe the regulation should be revised to exclude third parties who may hold information relevant to a taxpayer under audit. Government Code section 15618 gives the Board the authority to examine books, accounts, and papers of all persons required to report to it, or having knowledge of the affairs of those required to report. Board staff routinely requests information from third parties for collection or audit purposes.

## **VI. Alternative 1 - Staff Recommendation**

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given our limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board staff.



**A. Description of Alternative 1**

Exhibit 5 includes a flowchart and timeline showing the general audit process. Proposed Regulation 1698.5 includes:

- The requirement that a detailed audit plan is prepared for all audits; audit staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe;
- An IDR process when the taxpayer does not provide records in response to an auditor's verbal requests for information;
- An AFPS process to inform taxpayers of proposed adjustments when an area of audit work is completed; and
- That in general, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit for prior periods or until an appeal of a prior audit completes the appeal process.

**B. Pros of Alternative 1**

- By formalizing audit procedures in a regulation - rather than revising the Board's Audit Manual - the procedures are clearly intended to guide Board staff and taxpayers. Providing consistent definitions and procedures allows people with various levels of expertise to navigate through complex audit processes.
- Regulations are more accessible to the public than the Board's Audit Manual.
- Communication between Board staff and the taxpayer is improved through the audit plan, status conferences, and AFPSs.
- Improvements to the audit process may lead to the timelier resolution of audits, potentially reducing audit interest accruals.

**C. Cons of Alternative 1**

Interested parties believe the regulation's imprecise language will lead to inconsistency in how taxpayers are treated and disputes over how to interpret terms. Furthermore, as a possible outcome of these disputes, a perceived failure of Board staff to follow the regulation could result in litigation to resolve the disputed interpretation and to compel the Board to follow the regulation.

**D. Statutory or Regulatory Change for Alternative 1**

No statutory change is required. However, staff's recommendation does require adoption of a new regulation.

**E. Operational Impact of Alternative 1**

Staff will notify taxpayers of the new regulation through an article in the Tax Information Bulletin (TIB) as well as offer taxpayer outreach seminars. Staff also intends to prepare guidelines of best audit practices and provide training to all field audit staff and supervisors. The procedures will also be incorporated into the Board's Audit Manual, publications, and training materials.



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**F. Administrative Impact of Alternative 1**

**1. Cost Impact**

The workload associated with publishing the regulation, the TIB, and the best audit practice guidelines is considered routine. Any corresponding cost would be absorbed within the Board's existing budget.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1).

**G. Taxpayer/Customer Impact of Alternative 1**

Staff believes the overall impact on taxpayers will be minimal as many of the procedures are already in the Board's Audit Manual. New procedures are designed to improve communication with the taxpayer and improve audit efficiency. Resolving audits more quickly may result in saving taxpayers interest on audit assessments.

As explained in the Discussion section, interested parties believe several of the procedures will be difficult for taxpayers to comply with, and are a step backward from current policy.

**H. Critical Time Frames of Alternative 1**

Implementation will begin 30 days following approval of the regulation by the State Office of Administrative Law.

**VII. Other Alternatives**

**A. Description of Alternative 2**

Do not approve proposed Regulation 1698.5.

**B. Pros of Alternative 2**

Most of the procedures in the proposed regulation could be added to the Board's Audit Manual. Consequently, the regulation could be viewed as unnecessary. Not promulgating the regulation would avoid interested parties concerns regarding the regulation. The Board would also avoid the workload involved with processing and publicizing the regulation.

**C. Cons of Alternative 2**

Staff believes incorporating procedures into a regulation will result in a higher level of understanding and compliance than if the procedures were included in the Board's Audit Manual.

**D. Statutory or Regulatory Change for Alternative 2**

None.

**E. Operational Impact of Alternative 2**

None.

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**F. Administrative Impact of Alternative 2**

**1. Cost Impact**

None.

**2. Revenue Impact**

None.

**G. Taxpayer/Customer Impact of Alternative 2**

None.

**H. Critical Time Frames of Alternative 2**

None.

**Preparer/Reviewer Information**

Prepared by: Tax Policy Division, Sales and Use Tax Department

Current as of: November 2, 2009



## REVENUE ESTIMATE

STATE OF CALIFORNIA  
BOARD OF EQUALIZATIONBOARD OF EQUALIZATION  
REVENUE ESTIMATE

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**Proposed regulation for audit procedures in general**

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**Alternative 1 – Staff Recommendation**

Staff recommends the Board approve and authorize publication of Regulation 1698.5, *Audit Procedures*, as proposed in Exhibit 2. Staff has the duty to develop the most efficient audit process given their limited resources. Staff believes that incorporating general audit procedures into a regulation will help staff meet this responsibility. The proposed regulation formalizes audit expectations and documents the audit process for taxpayers and Board of Equalization staff.

**Alternative 2 – Other Alternative Considered**

Do not approve proposed Regulation 1698.5.

**Background, Methodology, and Assumptions****Alternative 1 – Staff Recommendation**

Staff believes that incorporating general audit procedures into a regulation will help staff meet the responsibility for developing the most efficient audit process given their limited resources. The staff recommendation contends that the new regulation formalizes audit expectations and documents the audit process for taxpayers and Board staff.

There is nothing in the staff recommendation that should necessarily impact sales and use tax revenue. However, to the extent that a regulation would be more authoritative than an Audit Manual in ensuring more timely completion of audits and refund claims, there could be an uncertain impact on sales and use tax revenue. That is, incorporating procedures into a regulation may lead to records being provided sooner, allowing for an earlier resolution of an audit. If the documents or information requested indicated that a taxpayer over paid his or her tax obligation, the resulting refund would be accelerated; the taxpayer would benefit from the discovery and the Board may pay less in credit interest. Conversely, if the Board discovered that the taxpayer failed to pay its sales and use tax obligations, the resulting earlier determination could mean acceleration in collections; the taxpayer would have a potential savings in debit interest.

Revenue Estimate

**Alternative 2 – Other Alternative – do not revise Regulation 1698.5**

There is nothing in the alternative 2 that would impact sales and use tax revenue.

**Revenue Summary**

Alternative 1 – staff recommendation should not necessarily impact revenue; nonetheless, to the extent that a regulation would be more authoritative than an Audit Manual in ensuring timely resolution of audits and refund claims, there could be an uncertain impact on sales and use tax revenue.

Alternative 2 – alternative 2 does not have a revenue impact.

**Preparation**

Mr. Bill Benson, Jr., Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Robert Ingenito, Chief, Research and Statistics Section, Legislative and Research Division and Mr. Jeff McGuire, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at 916-445-0840.

Current as of November 2, 2009.



## **Regulation 1698.5. AUDIT PROCEDURES**

Reference: Sections 7053 and 7054  
Records, see Regulation 1698

### **(a) DEFINITIONS.**

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (9) DAY. For the purposes of this regulation, "day" means calendar day.

### **(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

- (1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.
- (2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.



(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(8) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(8) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested



by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

### **(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference. On audits where electronic records are involved, the



Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Claims for Refund. Taxpayers or their representatives should present claims for refund at the beginning of the audit. A claim for refund that is presented near the conclusion of the audit may be addressed separately so as not to delay the timely completion of the current audit.

(8) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(9) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(10) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.



1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(11) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(12) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

District Office Address

District Office Address

xxx-xxx-xxxx • FAX xxx-xxx-xxxx

www.boe.ca.gov

**INFORMATION/ DOCUMENT REQUEST**

**TO:**

Taxpayer:

Case ID Number:

Account Number:

Audit Period:

**Date:**

**FROM:**

Auditor:

Office Making Audit:

Telephone:

Fax:

**Request No.** \_\_\_\_\_

**Due Date to Respond:** \_\_\_\_\_

**Requested Information/Documents:**

(Example: Chart of accounts, general ledger, sales journal, and accounts payable journal for the audit period noted above.)

**History Section**

**Verbal Request:**

Verbal request for this information was made on [date] with due date of [date].

**Partial Response (if applicable):**

(Example: Chart of accounts and general ledger were provided on [date].)



Taxpayer:  
Account Number:  
Case ID:

-2-

**First Written Request**

Initial IDR# [number] issued on [date] with due date of [date]

**Second Written Request**

Second IDR# [number] issued on [date] with due date of [date]

**Formal Notice and Demand**

A formal demand was issued on [date] with a due date of [date].

---

**History of IDRs**

Date

xx/xx/xx  
xx/xx/xx  
xx/xx/xx

IDR Status

Initial IDR  
No response from taxpayer. Issued second IDR  
No response from taxpayer. Issued Formal Notice  
and Demand

Due Date

xx/xx/xx  
xx/xx/xx  
xx/xx/xx

Draft



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

District Office Address

District Office Address

xxx-xxx-xxxx • FAX xxx-xxx-xxxx

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**AUDIT FINDINGS PRESENTATION SHEET (AFPS)**

**AFPS #:** \_\_\_\_\_ **AUDIT FINDINGS FOR:** (Example: Disallowed Claimed Sales for Resale)

Date:

**Due Date to Respond:**

Auditor:

Auditor Telephone #:

Taxpayer:

Account Number:

Case ID Number:

Audit Period:

DESCRIPTION OF FINDINGS	SCHEDULE REFERENCE	ESTIMATED TAXABLE MEASURE	TAXPAYER AGREES Y/N

*The audit findings presented are the auditor's proposed recommendation for determination and are subject to further review. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.*

*Taxpayers may use audit pre-payment form BOE-1 if at any time during the audit they wish to pay all or part of the proposed audit liability. Advance payment of the tax portion will stop the accrual of interest; however, it will not affect your right to appeal portions of the audit with which you do not agree.*

**SUMMARY OF FINDINGS:**



-2-

**LAW/REGULATION SECTION:**

**AUDITOR'S POSTION:**

**TAXPAYER'S POSITION:** (If you do not agree, please state your reason and attach the necessary documentation to support your position.)

*Draft*

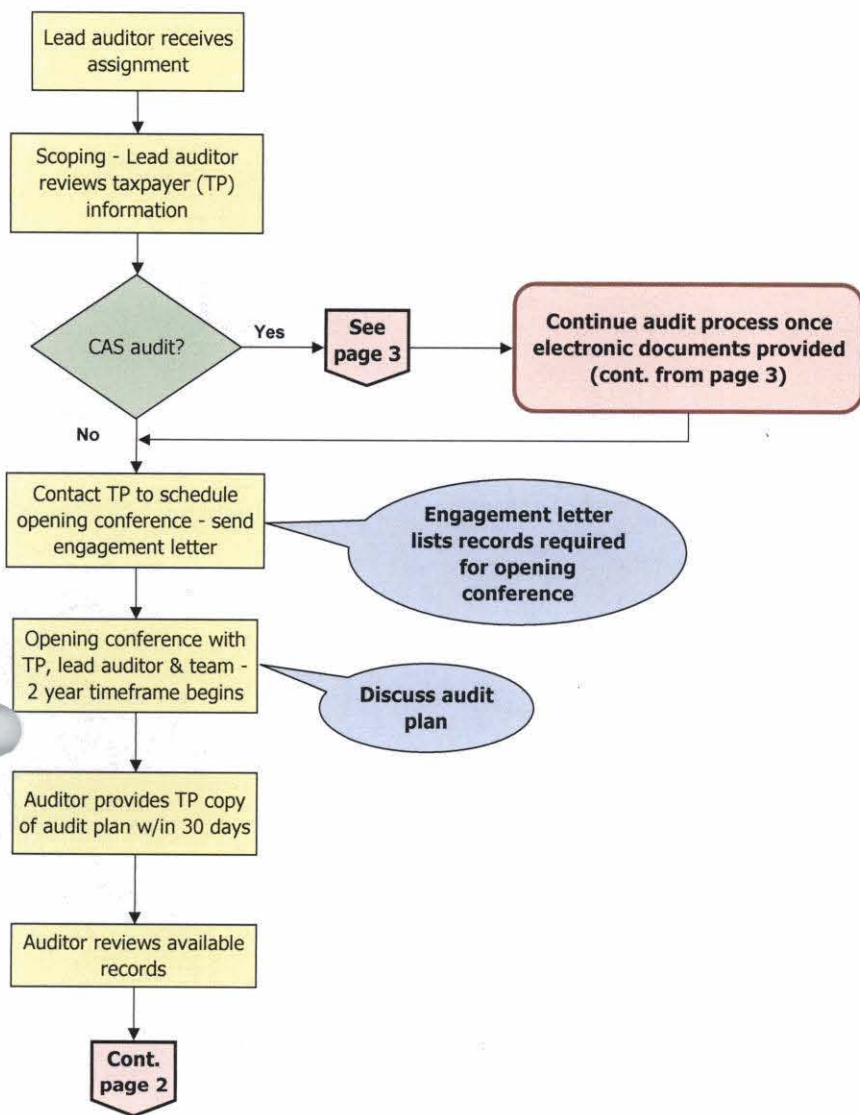
Signature of Taxpayer: \_\_\_\_\_

Date: \_\_\_\_\_

Signature of Taxpayer's Representative (if applicable): \_\_\_\_\_

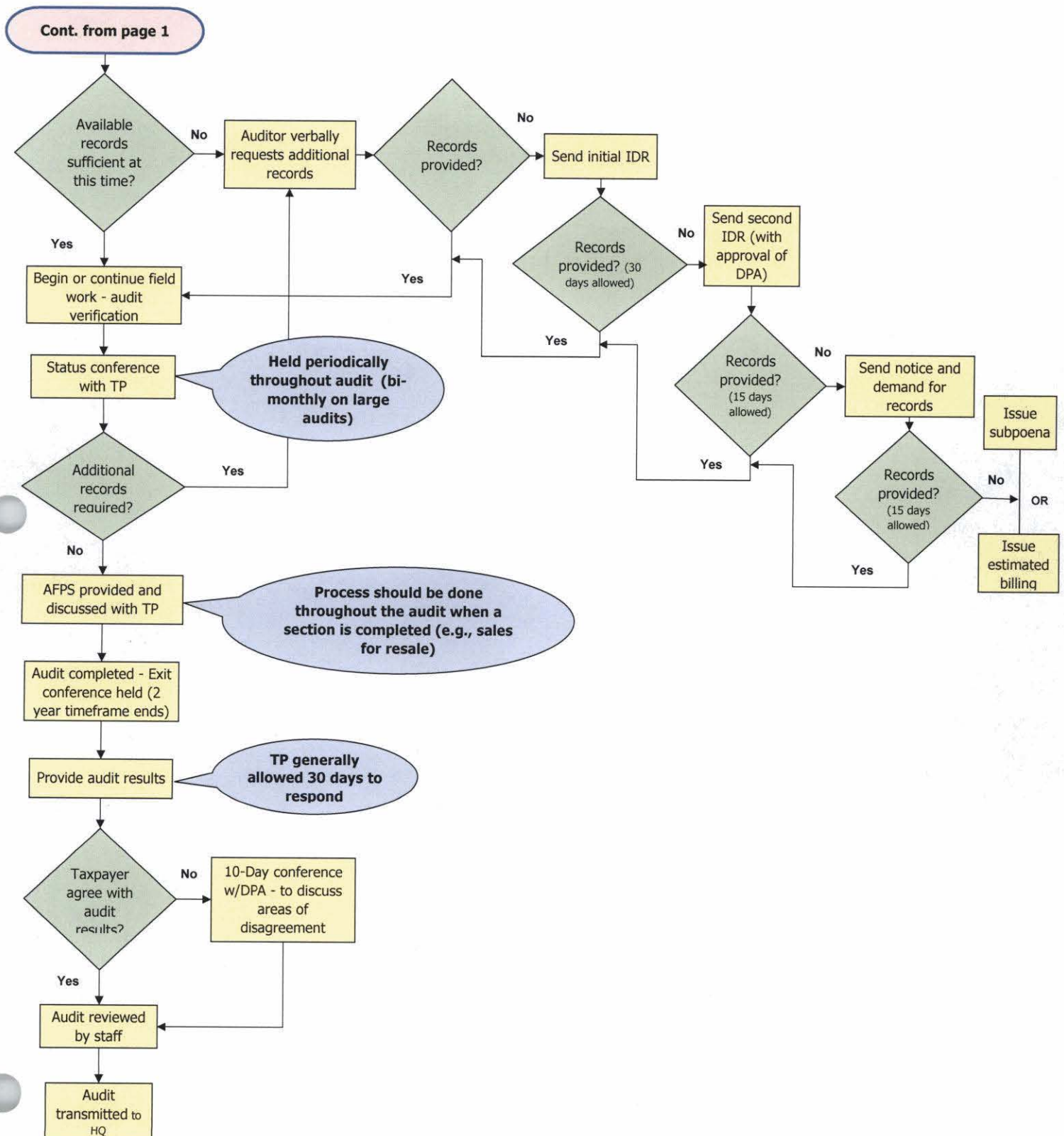
Date: \_\_\_\_\_

## AUDIT PROCESS

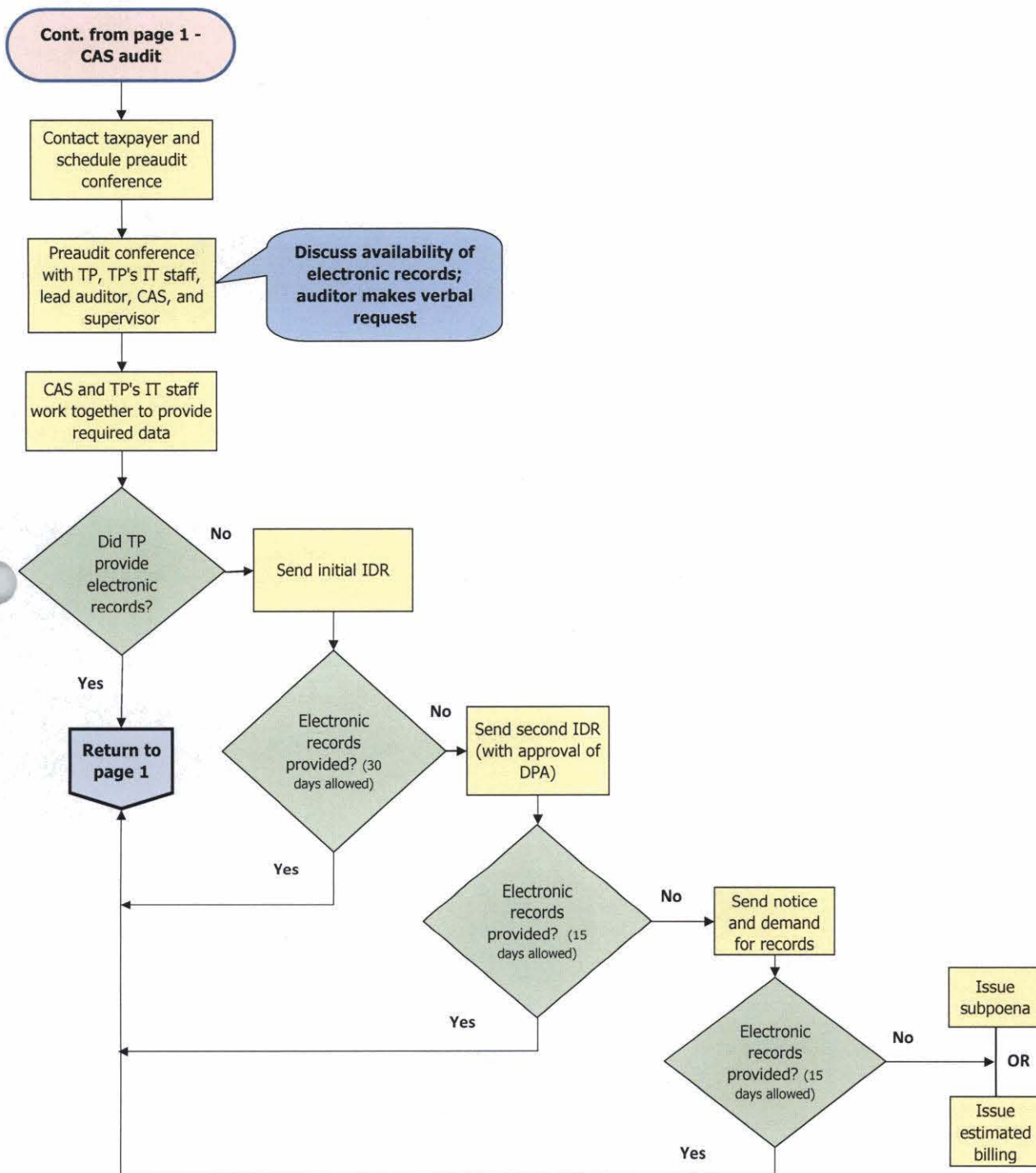




## AUDIT PROCESS

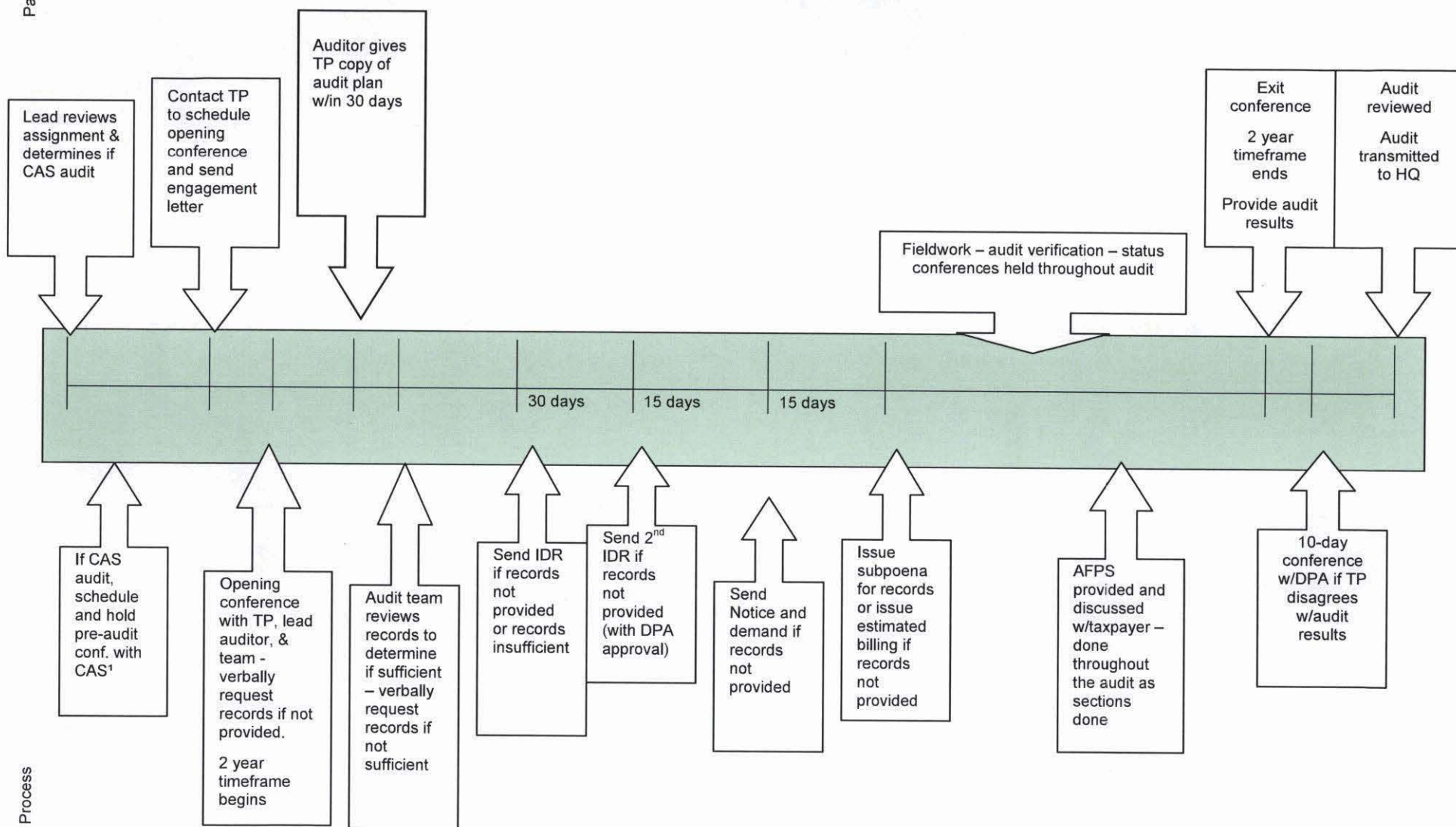


## AUDIT - Computer Audit Specialist (CAS) PROCESS





# Audit Process



<sup>1</sup>Refer to page 3 of the flowchart for CAS process



## BOARD OF EQUALIZATION

**BUSINESS TAXES COMMITTEE MEETING MINUTES**

HONORABLE BETTY T. YEE, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: NOVEMBER 17, 2009, TIME: 9:30 A.M.

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**ACTION ITEMS & STATUS REPORT ITEMS****Agenda Item No: 1****Title: Proposed regulation for audit procedures in general****Issue/Topic:**

Should a new regulation be adopted that would outline general audit procedures?

**Committee Discussion:**

Staff presented proposed Regulation 1698.5, *Audit Procedures*, explaining the general purpose and need for the regulation. Several interested parties addressed the Committee. Some stated their opposition to the regulation and preference that the procedures be included in the Board's Audit Manual. Other interested parties explained that they were initially opposed to the regulation, but have worked with staff on revisions and are now neutral.

Staff responded to questions from Board Members regarding several provisions of the proposed regulation including the handling of concurrent audits, claims for refund presented at the end of the audit, and requests to change the location of an audit.

**Committee Action/Recommendation/Direction:**

Upon motion by Ms. Yee, seconded by Mr. Horton, the Committee approved and authorized for publication Alternative 1 – Staff Recommendation with revision to subdivision (c)(4) as recommended by Ms. Mandel<sup>1</sup> and with the deletion of subdivision (c)(7) Claims for Refund. The vote was as follows:

MEMBER	Yee	Leonard	Steel	Horton	Mandel
VOTE	Y	N	N	Y	Y

There is no operative date, and implementation will take place 30 days after approval by the Office of Administrative Law. A copy of proposed Regulation 1698.5 including the approved revisions is attached. The approved revisions are identified with tracking marks.

<sup>1</sup> Added underlined text to the second paragraph of subdivision (c)(4): "Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal."



/s/ Betty T. Yee

Honorable Betty T. Yee, Committee Chair

/s/ Ramon J. Hirsig

Ramon J. Hirsig, Executive Director

BOARD APPROVED

at the November 19, 2009 Board Meeting

/s/ Diane Olson

Diane Olson, Chief  
Board Proceedings Division

**Regulation 1698.5. AUDIT PROCEDURES**

*Reference:* Sections 7053 and 7054  
Records, see Regulation 1698

**(a) DEFINITIONS.**

- (1) **BOARD.** For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) **PRE-AUDIT CONFERENCE.** A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) **OPENING CONFERENCE.** The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) **STATUS CONFERENCES.** Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) **EXIT CONFERENCE.** The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) **INFORMATION/DOCUMENT REQUEST (IDR).** A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) **AUDIT FINDINGS PRESENTATION SHEET (AFPS).** A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (8) **RECORDS.** For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (9) **DAY.** For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

- (1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.
- (2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations

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The proposed amendments contained in this document may not be adopted. Any revisions that are adopted may differ from this text.



to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(87) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(87) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

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(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

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(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(87) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

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Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

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During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

~~(7) Claims for Refund. Taxpayers or their representatives should present claims for refund at the beginning of the audit. A claim for refund that is presented near the conclusion of the audit may be addressed separately so as not to delay the timely completion of the current audit.~~

(8) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(9) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

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(409) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(410) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(421) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an

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explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

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BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

NOVEMBER 17, 2009

BUSINESS TAXES COMMITTEE

Reported by: Juli Price Jackson

No. CSR 5214



## P R E S E N T

For the Board  
of Equalization:

Betty T. Yee  
Chair

Jerome E. Horton  
Member

Bill Leonard  
Member

Michelle Steel  
Member

Marcy Jo Mandel  
Appearing for John  
Chiang, State  
Controller  
(per Government Code  
Section 7.9)

Joann Richmond  
Board Proceedings  
Division

---oOo---

For Sales & Use  
Tax Department:

Jeff McGuire  
Freda Orendt

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Dan Davis	37
Jesse McClellan	39

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450 N STREET

SACRAMENTO, CALIFORNIA

NOVEMBER 17, 2009

---oOo---

MS. RICHMOND: Our next item on the agenda is the Business Taxes Committee.

Ms. Yee?

MS. YEE: Okay, thank you very much.

Let us convene the Business Taxes Committee. We have one item on the Committee's agenda.

Mr. McGuire, do you want to introduce the item?

MR. MC GUIRE: Good morning, I'm Jeff McGuire with the Sales and Use Tax Department.

With me this morning is Ms. Freda Orendt. She's also with the Sales and Use Tax Department.

As you mentioned, we have one agenda item for your consideration today that involves a proposed new Regulation 1698.5, Audit Procedures.

This regulation will provide taxpayers and Board staff with procedures and guidance to facilitate the efficient and timely completion of an audit.

The regulation also provides procedures for timely communication between Board staff and taxpayers. More specifically, the regulation addresses the duties of Board staff and taxpayers in the audit process, formalizes procedures related to audit plans, timely resolution of audits, waivers of limitation, requests for information and presentation of audit findings.

1           Alternative 1, which is recommended by staff  
2 requests Board approval and authorization to publish  
3 Regulation 1698.5, Audit Procedures.

4           And then Alternative 2, which is recommended by  
5 interested parties, would not approve the regulation.

6           We do respectfully request your approval of one  
7 of these alternatives. And I know we have several  
8 speakers today and Freda and I are both available to  
9 answer any questions that you have.

10          MS. YEE: Okay, thank you.

11          Ms. Orendt, do you have any comments at this  
12 time?

13          MS. ORENDT: Just a few brief.

14          I think we've made a lot of progress during the  
15 interested parties meetings that we've had. We do  
16 believe that the language now is much more acceptable to  
17 many of the interested parties, as they've shared with  
18 me.

19          And it provides for an orderly process that  
20 leads to a timely progress and completion of the audit.  
21 It sets out our expectations very clearly as to how an  
22 audit should progress for both our taxpayers and our  
23 Board staff.

24          MS. YEE: Okay, thank you very much.

25          We do have a number of speakers on this item.  
26 Let me call you up three at a time, if I may?

27          First, if Joe Vinatieri, Michele Pielsticker  
28 and Kyla Christoffersen will come forward?



1 And if you'll introduce yourselves for the  
2 record and I'm going to give you two minutes each.

3 ---000---

4 JOSEPH VINATIERI

5 ---o0o---

6 MR. VINATIERI: Good morning, Joe Vinatieri.

7 Interesting hearing your discussion about the  
8 problems with this Headquarters, I thought local  
9 government had lots of dysfunctional issues. I think  
10 can see that the State, obviously, has many of the same.

11 MR. LEONARD: Does Whittier want to buy a City  
12 Hall?

13 MR. VINATIERI: Whittier's actually doing  
14 fairly well, considering.

15 MR. LEONARD: Sorry.

16 MR. VINATIERI: But we don't need a building up  
17 here, thank you.

18 Okay, good morning. Thanks for the opportunity  
19 to present some comments. And thanks to the staff for  
20 their efforts.

21 I've been involved in literally hundreds of  
22 audits over the years and from large and complex Fortune  
23 100 taxpayers to small mom and pop restaurants, who were  
24 having markup cases -- each one with both general and  
25 unique features.

26 There are many admirable aspects to this  
27 proposed regulation, but, however, because of the --  
28 what I call the one size fits all or the tie the hands

1 of the audit staff and taxpayer type of nature of the  
2 proposed reg, I oppose the proposed reg as a regulation.

3 For example, Section C4 provides that a  
4 follow-up audit, where the issues are the same as in a  
5 prior audit and which is under appeal, shall not be held  
6 in abeyance, even though the appeal of the prior audit  
7 will resolve the issues in the follow-up audit.

8 We've done this on many occasions. We've held  
9 it up and it would save both State and the taxpayer time  
10 and money because it resolved all of the issues doing  
11 that prior audit.

12 We don't -- really don't want to lose the  
13 flexibility of that type of opportunity here.

14 Another example, Section C8, provides a  
15 two-year period to complete an audit, which generally is  
16 a very reasonable time frame. And I appreciate the fact  
17 that the staff has modified the previous two-year  
18 language in the original draft, but as part of a  
19 regulation, I am concerned that the field audit staff  
20 will see the two years as a rule and not as a flexible  
21 standard.

22 There are some other examples, but to be brief,  
23 I have a suggestion for the Board. And that is, much of  
24 the proposed language here is very helpful and is good  
25 policy. It's policy that should, however, be in the  
26 audit manual.

27 I encourage you to put much of the proposed  
28 text in the audit manual, not in an inflexible



1 regulation that has the force and effect of law, and to  
2 see how it works.

3 By doing this, you can monitor the impact on  
4 taxpayers and the field audit staff to insure  
5 effectiveness and fairness without possible  
6 unanticipated and unintended potential negative  
7 consequences.

8 I appreciate your time. And thank you very  
9 much.

10 MS. YEE: Thank you very much, Mr. Vinatieri.

11 Next speaker?

12 ---o0o---

13 MICHELE PIELSTICKER

14 ---o0o---

15 MS. PIELSTICKER: Good morning, Michele  
16 Pielsticker, California Taxpayers' Association.

17 We were opposed to this regulation initially.  
18 And as a result of the interested parties process and  
19 efforts on the part of staff to hear our concerns and  
20 address them, we are now neutral.

21 And I just want to express my appreciation for  
22 the process with regard to this regulation. I  
23 appreciate staff's willingness to hear our concerns, to  
24 try to address them.

25 And I hope that we can continue to work  
26 together as we move forward on this.

27 I just want to mention I too have a couple of  
28 outstanding issues that I hope that -- that we can

1 address as we move forward in this process. One is the  
2 issue of concurrent audits, as Mr. Vinatieri suggested.

3 And the other is the issue of claims for refund  
4 being put over if they're not addressed at the beginning  
5 of the audit or if they are, conversely, put forward  
6 toward the end of an audit.

7 There is an interest differential between  
8 overpayments and underpayments and that could -- that  
9 could mean a significant dollar amount for taxpayers.  
10 And there doesn't seem to be, as yet, a clear definition  
11 as to what constitutes, "near the end of the audit."

12 And we would just appreciate focusing on this  
13 issue as we move forward.

14 And, again, we appreciate your efforts. Thank  
15 you very much.

16 MS. YEE: Thank you very much, Ms. Pielsticker.

17 Next speaker, please?

18 ---o0o---

19 KYLA CHRISTOFFERSEN

20 ---o0o---

21 MS. CHRISTOFFERSEN: Good morning, Kyla  
22 Christoffersen on behalf of the California Chamber of  
23 Commerce.

24 Similarly, we had taken an opposition position  
25 on the initial versions of this regulation, but we are  
26 pleased to remove that opposition at this time and are  
27 now neutral as well.

28 We also are very appreciative of the process



1 and that so many the business community's concerns were  
2 addressed by Board staff and the Members.

3 And we -- and in terms of remaining concerns,  
4 they are the same as those expressed by Cal-Tax.

5 But, anyway, thank you very much for being so  
6 responsive to our concerns.

7 MS. YEE: Thank you very much,  
8 Ms. Christoffersen.

9 Let me call the next three speakers up. But  
10 maybe -- and while they come up, if staff could address  
11 the issue of concurrent audits and the claims for  
12 refunds and some of the comments that were made by our  
13 speakers?

14 And while you do that, if Gus River and Dan  
15 Davis and Jesse McClellan could come forward?

16 MS. ORENDT: In the case of concurrent audits,  
17 I'd first like to point out that the language was  
18 intentionally left to be very flexible in the  
19 regulation.

20 We start off the sentence,  
21 "Generally, the Board will not hold in abeyance  
22 the start of an audit pending the outcome of  
23 the conclusion of the prior audit or pending  
24 the completion of appeals."

25 We did additionally add an additional sentence  
26 stating,

27 "In cases where prior audit is under appeal,  
28 the Board will begin the current audit by

1           examining areas that are not affected by the  
2           outcome of the appeal."

3           I think the combination of that flexibility and  
4           the clarity with regard to issues that are under appeal,  
5           I think, gives us exactly what we have now.

6           We do have the flexibility when we believe it  
7           is appropriate to hold on starting or completing a  
8           subsequent audit.

9           So, we believe that those are responsive to the  
10          concerns that have been raised.

11          With regard to the claim for refund issue, and  
12          in this case we are concerned that we do have  
13          situations -- and continue to have situations -- where a  
14          taxpayer will wait until the audit is completed and they  
15          wait to determine -- to find out what the liability will  
16          be and then they decide whether they'll will file a  
17          claim for refund and hire somebody to do what they call  
18          a reverse audit to find credits.

19          We would like to introduce that claim for  
20          refund concept earlier in the process. And that's why  
21          it will be discussed at the beginning of the audit in  
22          both the pre-audit conference and the opening  
23          conference.

24          If, in fact, the taxpayer does wait until the  
25          completion of the audit, we can process that audit and  
26          then subsequently process either a re-audit or a field  
27          billing order at a later time and still provide the  
28          taxpayer the benefit of that interest differential that



1 I believe Ms. Pielsticker made reference to.

2 So, they would not be -- it would not be  
3 detrimental to a taxpayer in terms of any credits that  
4 are subsequently allowed, subsequent to the completion  
5 of the audit.

6 MS. MANDEL: Could you -- could you run that by  
7 me one more time about the interest?

8 MS. ORENDT: Right. Well, currently in an  
9 audit if somebody raises a claim for refund, those  
10 credits offset the debits.

11 MS. YEE: Right.

12 MS. ORENDT: And it's just the net amount that  
13 we assess the tax at the debit -- we call the debit  
14 interest rate.

15 MS. MANDEL: Right.

16 MS. ORENDT: Now if we assess it in the audit  
17 and we don't have those credits because we haven't been  
18 provided the documentation, it's assessed at that debit  
19 rate.

20 Later the claim for refund is processed and  
21 they make an adjustment so that they would get the same  
22 offsetting interest as that debit rate, even though it's  
23 processed as a separate document.

24 MS. MANDEL: Okay. So -- so, I get a  
25 deficiency, or what do we call it here, Notice of  
26 Determination for \$100. And I have a refund claim that  
27 I filed that you guys didn't want to hold up your  
28 determination for \$50.

1           At the time that you finally process the \$50  
2 refund, you're going to put it in the system somehow --  
3 I'm just wondering how -- because the rates are  
4 different and I'm just wondering how it works because  
5 the concern is that my audit will be done, I'll get the  
6 determination and, let's say -- I mean I guess I  
7 understand if the audit is protested, that, you know,  
8 that it might still somehow be open and not final and  
9 maybe the refund claim somehow catches up with it.

10           But what about where, yeah, I owe that much  
11 money, but, by the way, I had this other thing that  
12 offsets it?

13           I'm just wondering how it fits in because  
14 people are real concerned about this and we -- you know,  
15 it's not like the other interest rates where we don't  
16 have parity. We've tried to get parity back so many  
17 times and we can't get it back.

18           So, I'm just not -- I mean, if people are  
19 concerned about this, it must -- I am not following how  
20 it how it happens in the system.

21           MS. ORENDT: In the audit situation that I  
22 described, where we've done an audit, we've worked on it  
23 for a few years, we've come up with a liability, let's  
24 say it is \$100 -- hopefully, it's much more if we've  
25 worked --

26           MS. MANDEL: The taxpayer hopes it's not.

27           MS. ORENDT: -- for years on this audit, but --

28           MS. MANDEL: It's easier to do the math that



1 way.

2 MS. ORENDT: Right, right.

3 So, they file claim for refund at the end of  
4 the audit. So, the claim for refund is timely, so,  
5 that's a concern.

6 If it ends up where there's a \$50 credit, if we  
7 process it, let's say in the case of processing -- using  
8 the vehicle of reaudit, then that \$50 credit's going to  
9 be net against the original \$100 liability and the  
10 interest would be computed on the \$50 balance.

11 MS. MANDEL: Right. That's if --

12 MS. ORENDT: So, the effective --

13 MS. MANDEL: -- that's if the audit is -- the  
14 audit and the determination on the audit is somehow  
15 still alive in our system? Or it's just whenever we get  
16 to it we're going to treat it as a reaudit?

17 That's the part I'm missing.

18 MS. ORENDT: Well, it's conditioned. All this  
19 is conditioned on what's typically happening now -- the  
20 claim for refund being processed timely so that that  
21 entire period is still open -- open to the statute.

22 Another example would be in that same example,  
23 somebody goes ahead and pays that liability and files a  
24 petition or claim for refund for the payment made on the  
25 audit.

26 MR. HORTON: Well, may I?

27 MS. MANDEL: Yeah, go ahead.

28 MR. HORTON: Madam Chair?

1 MS. YEE: Yes?

2 MR. HORTON: Seems to me that the concern is is  
3 that under the federal law they're allowed an offset --  
4 they call it offsetting interest. And the offset is  
5 consistent with the debit interest.

6 And, so, it seems that the concern is is  
7 that -- it's a timing matter and that interest is not  
8 necessarily calculated on the total amount. Interest is  
9 calculated at the point in which the liability was due.

10 And, so, there, in effect, you could have a  
11 situation -- and I'm presuming a credit interest will be  
12 calculated the same way at the point that the credit was  
13 due.

14 Is that correct or not?

15 MS. ORENDT: It would be for the period --

16 MR. HORTON: For the period in which --

17 MS. ORENDT: -- in which that credit was due,  
18 at whichever quarter it was, the same way we would  
19 assess a liability.

20 MR. HORTON: -- so, are you sharing with us  
21 that we have the authority to provide offsetting  
22 interest in a subsequent action of the Board of  
23 Equalization?

24 Let's say, for example, we did an audit of a  
25 three-year period, 2006 through 2009. And then a year  
26 later the taxpayer came back and filed a claim for  
27 refund under the --

28 MS. ORENDT: That's not -- that's not what I'm



1 referring to.

2 I'm referring to a situation where they filed a  
3 claim for refund when the audit was not yet determined  
4 for the same period that was open and the same period  
5 covered by the audit.

6 And that's what typically happens. They don't  
7 yet know the amount and that's why we get so many claims  
8 for refund for \$1 and they don't specify the amount.

9 MS. MANDEL: They don't know the amount of the  
10 claimed refund?

11 MS. ORENDT: Correct, correct.

12 MR. HORTON: And, so --

13 MS. ORENDT: So, this would only work as I  
14 described, if they timely filed that claim for refund --

15 MR. HORTON: Okay.

16 MS. ORENDT: -- before the determination.

17 And that typically happens. They bring it up  
18 to us, not after we've determined it -- sometimes, they  
19 do, but the situation I described only covers the  
20 situation where the audit's in process, everything in  
21 that, let's say, three-year period is still open to  
22 statute. We have waivers to cover it. And within that  
23 period they file that claim for refund.

24 MR. HORTON: And what happens then when they  
25 file the claim for refund?

26 MS. ORENDT: Well, if the audit is completed,  
27 we would like not to hold up the completion of that  
28 audit and process it separately.

1           They've already filed the claim for refund.  
2       So, they've preserved --

3           MR. HORTON:   And what's -- what's our reasoning  
4       for doing that?

5           MS. ORENDT:   Because of the timeliness of  
6       completing the audits.

7           MR. HORTON:   No, I mean, we've --

8           MS. ORENDT:   We've --

9           MR. HORTON:   -- completed the audit for all  
10       practical purposes, we just haven't -- and a claim for  
11       refund is filed somewhere in the middle of the audit and  
12       we're now saying that, okay, we want to finalize the  
13       audit and then we'll deal with the claim for refund at a  
14       later date.

15           Why?

16           MS. ORENDT:   If it's filed during the course of  
17       the audit, we don't want to do that. We want to address  
18       it with the audit. We're only concerned in those  
19       situations --

20           MR. HORTON:   I thought the regs said that the  
21       claim had to be filed in the beginning of the audit.

22           MS. ORENDT:   -- I don't believe -- the claim  
23       for refund, taxpayer's or their rep --

24           MR. HORTON:   You said, "Generally speaking,"  
25       generally speaking?

26           MS. ORENDT:   Well, there's a separate section  
27       referring to C7 on claims for refund.

28           MR. HORTON:   Uh-huh.



1 MS. ORENDT: The claims for refund is a topic  
2 that's going to be -- the auditor is going to be  
3 required to discuss at the beginning of the audit and  
4 ask if there is any areas the taxpayers believe that  
5 they're due credits.

6 MR. HORTON: And they're required to do that  
7 now, right?

8 MS. ORENDT: They should be doing it now,  
9 yes.

10 MR. HORTON: They're not required to do it?  
11 They have an option?

12 I mean, I thought when you started --

13 MS. ORENDT: Well, it is a typical area that is  
14 supposed to be covered with each and every taxpayer.

15 I say "should" because we've heard that's not  
16 always done. I can't guarantee that it's done. It's  
17 our policy to have that discussed at the beginning of  
18 the audit.

19 So, under the claims for refund section is,  
20 "Taxpayers or their representative should  
21 present claims for refund at the beginning of  
22 the audit. A claim for refund that is  
23 presented near the conclusion of the audit may  
24 be addressed separately so as not to delay the  
25 timely completion of the audit."

26 We want to encourage the taxpayer to let us  
27 know if they believe any credits are due during the  
28 course of the audit, rather than waiting until an

1     audit's completed.

2             MR. HORTON: And I think there's a lot of  
3     wisdom in that.

4             But let's say they don't. What happens? I  
5     mean, what's the difference?

6             MS. ORENDT: If -- if they file that claim for  
7     refund timely, then they would have the benefit of  
8     getting this offsetting interest.

9             However, in the situation that you described,  
10    they wait for a year --

11            MR. HORTON: No, no, wait, I --

12            MS. ORENDT: -- after the determination.

13            MR. HORTON: I concur that the only time that  
14    this works -- in the example you provided, I concur.

15            So, let's stay with that example.

16            MS. ORENDT: Okay.

17            MR. HORTON: What happens?

18            MS. ORENDT: So, we'd issue the determination.  
19    They could, if there is other areas, file a claim for --  
20    a claim for refund if they paid it or petition.

21            But assuming they already filed that claim for  
22    refund, we're going to encourage them to give us the  
23    documentation to support that claim at the earliest  
24    possible date so we can establish what that credit is.

25            If that occurs after the determination is made  
26    for the audit liability, then we could do it via a  
27    re-audit for that same audit period because that time  
28    period is still open to statute because they timely



1 filed that claim for refund.

2 In a re-audit we take the original amount  
3 assessed and we offset anything that we reduced, such as  
4 the claim for refund in this case, and then compute  
5 interest on the net amount.

6 So, by doing it that way, they, in effect, are  
7 given the offsetting credit at the debit interest  
8 rate.

9 MS. MANDEL: So, that -- that -- so, that will  
10 happen, assuming the taxpayer on the particular audit  
11 for which they've lobbed in a refund claim that you  
12 didn't want to wait with closing out the audit and  
13 issuing a determination, that assumes that the taxpayer  
14 is still going through the administrative protest and  
15 appeal process or you've managed to figure out the  
16 refund claim before you actually do the deficiency --  
17 determination?

18 MS. ORENDT: Well, as long as they filed it  
19 while we still had --

20 MS. MANDEL: I understand.

21 MS. ORENDT: -- an active waiver covering the  
22 audit period.

23 MS. MANDEL: Okay. So, go back to my example.

24 Because the way I would understand it is they  
25 timely -- they filed the refund claim during the audit,  
26 the auditor hasn't walked out the door yet, but you  
27 think it's too late for the auditor to deal with and you  
28 want to close out the audit, you don't want to hold up

1 the issuance of the determination, even though, as  
2 Mr. Horton says, you've -- you know, you could have  
3 written up all of the work papers and everything, you  
4 don't want to hold up issuing that determination on the  
5 audit, you're going to separately review this particular  
6 claim for refund.

7 And ultimately in a re-audit, which you call a  
8 re-audit -- which it took me a little while sitting  
9 here to learn it wasn't an actual full re-audit, but  
10 just like recalculating the numbers -- that in a  
11 re-audit you would put that credit in, whatever is  
12 finally determined off that refund claim to be the  
13 appropriate amount of credit, you would put that in just  
14 like you would have had the original auditor done the  
15 work prior to the determination and it had been in the  
16 determination.

17 So, they get the benefit of the interest  
18 offsetting that they are looking at?

19 MS. ORENDT: That's correct --

20 MS. MANDEL: Okay.

21 MS. ORENDT: -- as long as the periods are all  
22 still open because of the timely filing.

23 MS. MANDEL: Right. And it seems to me that  
24 that sort of re-audit function that you all do happens  
25 either because the determination, you know, hasn't yet  
26 popped out of the system and miraculously you get to it  
27 in time, or the taxpayer protested or petitioned, I  
28 guess, is our technical word here, petitioned the



1 determination so that the -- that the determination was  
2 not final or -- and then that they were on appeal or if  
3 they filed a petition for redetermination that sometime  
4 in that whole time period before the determination goes  
5 final that refund claim is handled by the refund people  
6 who do that and can get factored in in a re-audit?

7 My original question was -- and the impression  
8 I had from part of the concern was -- that if -- if  
9 there's a determination that goes final, now, you know,  
10 the appeal process being what it is, but assume that the  
11 taxpayer didn't have a -- that the taxpayer agreed with  
12 the deficiency, the taxpayer didn't agree with that, but  
13 thought they had additional credits.

14 So, they're not going to -- you know, is the  
15 taxpayer going to have to file a petition to that  
16 determination to make sure that they're going to get  
17 this credit ultimately on a re-audit?

18 MS. ORENDT: Well, the reality is they are  
19 going to file a petition because they say they don't  
20 agree because they believe they're entitled to those  
21 credits.

22 MS. MANDEL: Okay.

23 MS. ORENDT: So, that is the reality that they  
24 will go through that petition process.

25 MS. MANDEL: Okay. Well, then, that closes  
26 that loop, I suppose.

27 Okay. Sorry, it took me so long to --

28 MS. ORENDT: And the other -- the other

1 consideration is that if it's a claim for refund, they  
2 can -- they will present, in short order, the -- even at  
3 the conclusion of the audit -- the documentation so that  
4 we can verify it.

5 We're going to include the audit. The problem  
6 we have, though, is some claim for refunds that are in  
7 process currently have been in process for more than  
8 five years. Sometimes it takes taxpayers very long to  
9 provide the documentation.

10 By asking and having a discussion of any areas  
11 of credit that are due at the beginning of the audit, we  
12 can sometimes have -- in a large audit -- have a  
13 computer audit specialist set up the test so that we  
14 give effect to the credits during the audit, so that  
15 they don't have to be handled separately.

16 So, we really want to encourage the taxpayer to  
17 raise any areas of credit they believe they are due up  
18 front so that they can be addressed during the audit  
19 process.

20 MS. YEE: Mr. Horton?

21 MR. HORTON: Madam Chair, I'm having a real  
22 problem understanding what we're accomplishing.

23 It seems to me that the audit plan, the  
24 management of the audit, most auditors that I know --  
25 and I know quite a few in this agency -- they actually  
26 do sit down with the taxpayer in the beginning. And  
27 they set forth a plan and strategies on how they're  
28 going to proceed, testing methods and so forth.



1           And there is a little check off that they check  
2 off relative to claims for refunds and it's all part of  
3 the training. I mean, I actually conducted quite a bit  
4 of training of audits -- auditors. And, so, it seems to  
5 be a professional judgment matter.

6           And if the taxpayer files a timely claim for  
7 refund or if we somehow finalize the audit and freeze  
8 the audit period and they file a subsequent claim for  
9 refund, I don't know what we have accomplished.

10          We're still going to provide credit interest.  
11 We're still going to do the work on the claim for  
12 refund. The only thing that we've done is prematurely,  
13 at this point, without this direction, we finalized an  
14 audit that isn't final because there is still areas of  
15 concern.

16          And we're -- we seem to be moving in the  
17 direction of making rules relative to the exception, not  
18 necessarily to the rule, and trying to give direction to  
19 the audit staff.

20          And, so, my question is, let's say currently in  
21 doing this what are we accomplishing that we can't  
22 already accomplish? And, if -- is there an  
23 additional -- an additional tax or additional  
24 convenience or reduction in time? Do we expedite the --  
25 do we minimize the time it takes to do the audit?

26          Theoretically if it takes, you know, 800 hours  
27 to do the audit and another hundred hours to do the  
28 claim for refund, it would take that hundred hours to do

1 the claim for refund and the 800 hours to do the audit.

2 Arguably, if we did it concurrently, we might  
3 be able to save some time if we're aware of it during  
4 the audit period because, you know, we can offset it  
5 right away. We can include it in our testing. It would  
6 be part of the projection. And, so, we actually save  
7 time.

8 MS. ORENDT: Correct.

9 MR. HORTON: In the current methodology this  
10 actually adds additional time because we may have -- we  
11 may be going over an area that we've already went over  
12 in the claim for refund. So, we've got to go back and  
13 retest and readjust and reextrapolate. So, we're adding  
14 additional time to it.

15 But if we want to encourage -- for those  
16 taxpayers that are using the claim for refund, if you  
17 will, as a way of offsetting their liability, seems to  
18 me they ought to do that anyway. I mean, that's  
19 something that they're entitled to do and they ought to  
20 be able to do it.

21 It sounds almost as if, though, the accounting  
22 personnel -- in this situation where there's abuse --  
23 the accounting personnel is using this as a tool if  
24 they -- if there is an audit liability.

25 There is audit liability, then they say,

26 "Oops, we got an audit liability. So, let's go  
27 in and have this reverse audit done so that we  
28 can find credits and the offset that audit



1 liability."

2 Whereas they might not do that if there wasn't  
3 an audit liability. They wouldn't go in and spend the  
4 money, time and energy to do the reverse audit.

5 Well, seems to me that person ought to be  
6 fired. I mean, if there's a credit due to the company,  
7 the company might want to be able to make that decision  
8 and do what they have to do in order to get that credit.  
9 Because typically these are large audits if they are  
10 delayed.

11 And, as you said earlier, if there -- if the  
12 audit is going on for two years, the auditor probably  
13 thinks there's a liability there. I mean, there is --  
14 otherwise they would do a quick no change and get out of  
15 there. So, there's probably a -- a significant  
16 liability to -- I mean, the auditor is kind of conscious  
17 of their time.

18 So, maybe you can just give me a little clarity  
19 as to what -- what we seek to accomplish and what the  
20 difference is.

21 Because my assessment is that this adds  
22 additional time, possibly, and there is -- and  
23 particularly when we're giving offsetting interest, and  
24 then I am little concerned whether or not we can  
25 actually do that.

26 I know we can do it in the audit, because we  
27 just offset it before the liability creates. But I  
28 don't know if we could finalize the audit, establish

1 debit interest and then turn around and do a separate  
2 FBO or separate document to identify credit -- a credit  
3 and say,

4 "Okay, now that we've got the audit with debit  
5 interest and now we have an FBO, we're going to  
6 somehow consolidate these two under a new  
7 vehicle and offset the two,"

8 or we're -- I'm just having a little problem  
9 figuring out how we're going to do that.

10 Maybe you can help me.

11 MS. ORENDT: I do believe by having the  
12 taxpayer and encouraging them, working with them,  
13 bringing the information on any credits to light at the  
14 beginning of the audit, we can verify and incorporate  
15 them in tests.

16 So, I do believe by doing that it would result  
17 in saving audit hours spent by our staff.

18 MR. HORTON: Give me an example.

19 MS. ORENDT: If -- if they believe they have --  
20 a taxpayer accrued tax on some of their paid bills, we  
21 typically look and do an accounts payable test during  
22 the audit. If we knew those specific areas, we could  
23 incorporate them in the test, test them separate, review  
24 them in some way.

25 We think it's for the computer auditor  
26 specialist and the auditor to decide the best approach.

27 But if we knew about them in advance, then we  
28 could handle them during the course of the audit rather



1 than waiting until the audit's completed.

2 MR. HORTON: Accrued interest is generally --  
3 accrued tax is generally on an actual basis and to the  
4 extent, we can, or it's on a projected basis.

5 And, so, if it didn't occur in the tests, the  
6 original tests that created the debit liability and the  
7 period is inconsistent with that, we would have the  
8 option of projecting the percentage of error against the  
9 credit and saying that credit exists over the audit  
10 period, or we would adjust the credit on the actual  
11 basis and offset just that actual amount.

12 Of course, the taxpayer might argue that that  
13 credit is consistent throughout the audit period,  
14 therefore, you ought to project that same percentage of  
15 error that did you on the debit to the credit and it  
16 results -- you know, it's the same thing.

17 MS. ORENDT: It would depend on how -- how the  
18 test was conducted, what accounts the auditor tested, if  
19 those accounts of interest included the areas that the  
20 taxpayer believed credits were due.

21 It would vary because every situation and every  
22 audit is different.

23 Oftentimes taxpayers don't make payment until  
24 they do get a bill. And the other thing that we would  
25 have to gain is that there are other areas of the audit  
26 where there is a liability that aren't going to be  
27 completely offset. And, again, this depends on the  
28 situation.

1           So, if we know there is a liability and we've  
2           given the taxpayer an opportunity throughout the audit  
3           process to make us aware of any credits, if they don't,  
4           then we would benefit by billing and at least then they  
5           would consider making payment toward that portion of the  
6           liability that has been determined that they believe  
7           will not be offset.

8           MR. HORTON: Madam Chair, if I may?

9           I know it's been going on for a while.

10          MS. YEE: Please.

11          MR. HORTON: The -- I mean, I agree with that.  
12          I mean, I think finalizing the bill accelerates the  
13          collection activity, although they're going to file a  
14          petition.

15          And, so, once they file the petition, you're  
16          not going to collect anything because you can't, you  
17          know, the law doesn't allow you. So, there goes that  
18          benefit.

19          You know, I mean, just if -- I may just  
20          conclude and share my thoughts -- is that we want to  
21          encourage the taxpayer to file a claim for refund, which  
22          is something in their best interests, because filing a  
23          claim for refund generally means that you're getting  
24          money back from the State of California. So, it's in  
25          their best interests to do so. We want to encourage  
26          that.

27          And our concern seems to be with these reverse  
28          audits, where they go in and we spend all these hours



1 and we didn't notice the claim for refund because it  
2 wasn't in our parameters of testing. And, so, we didn't  
3 notice it. And all of a sudden it comes up somewhere  
4 else.

5 And at their end, we -- the State of California  
6 has been harmed, I think, by the actions -- the  
7 dishonest actions of the taxpayer.

8 But mindful -- I mean, I happen to believe that  
9 most taxpayers are honest and that this is kind of like  
10 the exception of the rule.

11 And, so, as I said before, I have somewhat of a  
12 problem of codifying, you know, the exception into hard  
13 and fast.

14 But maybe as -- I mean, I don't know how to get  
15 there -- certainly to the audit staff we ought to be  
16 audit managers who are managing these larger audits.  
17 There should be discussions about the claim for refund,  
18 should be discussions about the test and the universe  
19 and all these other things and, possibly, we ought to  
20 require the District Principal Auditor to engage at an  
21 earlier stage in these audits or give the District  
22 Principal Auditor more authority somehow to have greater  
23 leverage over claims for refunds. I don't know.

24 And maybe we shouldn't allow offsetting  
25 interest, which I don't know if we can do legislatively  
26 -- statutorily, any way.

27 Any thoughts on how we can -- I mean, I am okay  
28 with the regulation because -- and I am okay with saying

1 what we're saying because we're saying, "generally, may,  
2 shall." So, we're still leaving it up to the discretion  
3 of the staff or the professional to make the final  
4 determination on how best to utilize this.

5 The inherent danger is is that you begin to  
6 modify behavior and that just seems to be some of the  
7 concerns. I mean --

8 MS. ORENDT: Right.

9 MR. HORTON: -- seems to me we have enough  
10 authority to modify the behavior of our own staff. And  
11 now modifying the behavior of the taxpayer, this is not  
12 going to accomplish that.

13 MS. ORENDT: If I might?

14 First of all, you made a comment I wanted to  
15 clarify. I didn't mean to say or imply by a taxpayer  
16 waiting that we view that -- I don't view that as being  
17 dishonest in any way.

18 You know, I -- they have resources, they have  
19 workload or --

20 MR. HORTON: I do if they do it intentionally.  
21 I mean, if it's intentional. I mean, because otherwise,  
22 if it's not intentional, then harm, no foul, it's a  
23 legitimate claim for refund, there's no intent behind  
24 it, they're not intending to delay the audit and this  
25 isn't necessary.

26 Our goal here is to deal with those who are  
27 intentionally delaying the audit and exposing the Board  
28 to -- to a loss of time and energy when, in fact, they



1 knew about it in advance.

2 And we're concerned as well about those who  
3 make financial determinations based on the audit  
4 liability instead of based on the facts and the law.

5 And that is something that, quite frankly, if  
6 we disclose or disclose to -- to the Board of Directors,  
7 the true decision makers here, they might be a little  
8 upset about that, about someone in the Accounting  
9 Department acting in that capacity -- knowing that there  
10 is a -- waiting until there is a liability before they  
11 exercise their fiduciary responsibility to protect the  
12 interests of that corporation and file claims for  
13 refunds.

14 I mean, that is -- that should be a  
15 determination or something.

16 MS. ORENDT: And that is one reason that we  
17 have included throughout the regulation, including on  
18 any correspondence or inviting to regular status  
19 meetings or the opening conferences, except conferences  
20 to taxpayers key decision makers, rather than just the  
21 person that's working with the auditor to make sure that  
22 they are kept in the loop and apprised throughout.

23 But in response to your question --

24 MR. HORTON: If I may ma'am?

25 There we go, that might be the solution.

26 The solution might be if, in fact, we feel that  
27 that is the case, that there is -- they're conducting a  
28 reverse audit, that they are acting in this capacity,

1 that we have the authority to disclose it to the Board  
2 of Directors or, however high up we need to go.

3 And we disclose that in the beginning, that

4 "Mr. CFO, here's what's going to happen."

5 If there's a subsequent claim for refund and  
6 for some reason we feel that -- that you were aware of  
7 that claim for refund, where you're conducting a reverse  
8 audit, we have been notified to make your superiors  
9 aware that they had a claim for refund and no one really  
10 took the due diligence to protect the -- to bring that  
11 claim for refund to notice.

12 They might act a little differently when you do  
13 that. Just a thought. But, again, it's professional  
14 judgment.

15 MS. ORENDT: Right.

16 MR. HORTON: It's management of the audit.  
17 It's something that we can't necessarily legislate.

18 And if you're saying that our staff needs  
19 additional training in this area, let's provide them the  
20 training.

21 MS. ORENDT: If I might make one last comment?

22 You mentioned the authority of the District  
23 Principal Auditor. The decision as to whether to  
24 process the audit or wait until the claim is verified is  
25 currently with and remains with the District Principal  
26 Auditor.

27 This language isn't intended to change it.  
28 And, in fact, this language really doesn't represent a



1 change.

2 The District Principal Auditor is also supposed  
3 to -- the normal course of action in processing any  
4 audits that non concurred and that he's aware that  
5 there's a disagreement, there's a ten day office  
6 discussion, they have the authority to hold the  
7 processing of that audit up if they show -- so believe  
8 that it's --

9 MR. HORTON: It's really a leading statement.  
10 I mean, I -- I mean, I was really getting back to the  
11 fact that I don't see the difference here. But, other  
12 than sending --

13 MS. ORENDT: So, with or without this language,  
14 I think --

15 MR. HORTON: -- we can do all of this.

16 MS. ORENDT: That's correct.

17 MS. YEE: All right, okay.

18 MR. LEONARD: Madam Chair?

19 MS. YEE: Thank you, Mr. Horton.

20 Mr. Leonard?

21 MR. LEONARD: I'm sorry to interrupt the  
22 speakers, but Mr. Horton, you outlined a procedure  
23 for -- in response to the earlier speaker's question  
24 about claims for refund in which even if it did come in  
25 late and was set aside and processed later, that it  
26 would all work out.

27 MS. ORENDT: If it was timely -- if it was  
28 timely filed within the statute.

1 MR. LEONARD: If it was timely filed within the  
2 statute? Okay.

3 MS. ORENDT: The period has to be open to  
4 statute.

5 MR. LEONARD: Where is that? Where is that  
6 procedure in this regulation?

7 MS. ORENDT: It's not spelled out in this  
8 regulation.

9 MR. LEONARD: Okay. Where is it?

10 MS. ORENDT: It's currently -- actually, in  
11 doing some research and discussions with the Audit  
12 Determination and Refund Section that processes our  
13 refund unit, it was through verbal discussions.

14 I'm not aware --

15 MR. LEONARD: So, it's not in the audit manual  
16 either?

17 MS. ORENDT: You know, I can't say that it's  
18 not. I wasn't able to find it. I don't know if  
19 maybe --

20 MR. LEONARD: So, the taxpayer's objection --

21 MS. ORENDT: -- Kevin Hanks may be aware of it.

22 MR. LEONARD: -- still has merit because your  
23 answer isn't in writing?

24 MS. MANDEL: If the taxpayer went online --

25 MR. LEONARD: Don't you agree?

26 MS. MANDEL: They wouldn't find it?

27 MR. LEONARD: They couldn't find it?

28 MS. MANDEL: That's what you're saying?



1 MS. ORENDT: I couldn't find it.

2 MR. LEONARD: I couldn't.

3 MS. ORENDT: In my research, when this was  
4 first brought up --

5 MR. LEONARD: I appreciate the answer  
6 because --

7 MS. ORENDT: -- I wasn't able to find it.

8 MR. LEONARD: -- I kind of like it, but I -- I  
9 don't see it.

10 MS. ORENDT: I'm going to -- yeah, I wasn't  
11 able to find it.

12 And, in fact, after the meeting I did ask that  
13 a memo be prepared to the District so that they are all  
14 aware of that.

15 It took research on my part and --

16 MR. LEONARD: If you are going to move from  
17 audit manual --

18 MS. ORENDT: -- and I am --

19 MR. LEONARD: -- regulation, maybe we should  
20 move this too.

21 Thank you, Madam Chair.

22 MS. YEE: Thank you, Mr. Leonard.

23 Let's resume the speakers. If you'll introduce  
24 yourself for the record, you have two minutes for your  
25 comments.

26 Thanks for your patience.

27 ---o0o---

28

1 GUS RIVERA

2 ---o0o---

3 MR. RIVERA: Hi there, I'm Gus Rivera and I'm  
4 with Intel Corporation. And I wanted to take this  
5 opportunity to -- to express my appreciation and commend  
6 the Board staff for working with taxpayers and, in my  
7 opinion, bringing the less than desirable original draft  
8 language to a more reasonable state as it's being  
9 recommended to you today.

10 MS. YEE: Thank you very much.

11 Next speaker?

12 ---o0o---

13 DAN DAVIS

14 ---o0o---

15 MR. DAVIS: Hi, I'm Dan Davis with Associated  
16 Sales Tax Consultants.

17 And I also wanted to thank the Board and the  
18 staff for the changes that they have made in the  
19 regulation to date that made it much more reasonable  
20 than it was.

21 However, I still have to agree with  
22 Mr. Vinatieri that the applicable provisions really  
23 should be in the audit manual.

24 It's providing a one size fits all approach to  
25 audits. And in the larger companies this is probably  
26 going to be less of a problem, but as you get down  
27 smaller and smaller, where you have most of your  
28 taxpayers, the mom and pop operations, this is, in some



1 ways, going to be very onerous to them. It gives the  
2 auditor a great deal of discretion, more so than it had  
3 before, in making demands of the parties.

4 And I'm only going to give one example because  
5 of the time frame. Paragraph C8, dealing with audits,  
6 the second paragraph of that section, I am sorry,  
7 Section C8 and that is the section addressing audit  
8 plans. And I'm specifically referring to the third  
9 sentence in that section, which is,

10 "The audit plan should be signed by the auditor  
11 and either the taxpayer or the taxpayer's  
12 representative to show a commitment by both  
13 parties that the audit will be conducted as  
14 described in the audit plan to allow for the  
15 timely completion of the audit."

16 Well, the fact is, I have no objection to the  
17 taxpayer signing the audit plan certifying that they  
18 read and understood the plan -- even though in most  
19 cases they will not on the level of small business  
20 people.

21 But as far as their being committed to the  
22 plan, this is putting the taxpayer in a box that the  
23 auditor can use later on to come back and whack them.

24 For example, an audit method that I'm seeing  
25 more and more in very small restaurants is a sit down  
26 test, where after the audit period, the auditor goes in  
27 and sits down for a day, tallies up what are taxable  
28 versus nontaxable sales and then applies that percentage

1 to the entire audit period.

2 And there are so many things that are -- that  
3 can be wrong with that approach. It's too difficult to  
4 address. I mean, it depends on what day of the week  
5 they are in, it depends on the season of the year, there  
6 could have been economic changes, changes in the  
7 environment over the three-year audit period, none of  
8 which are reflected in the test.

9 MS. RICHMOND: Time has expired.

10 MS. YEE: Thank you.

11 MR. DAVIS: May I just say that no taxpayer in  
12 their right mind should be required to commit to that  
13 kind of a test.

14 And that appears to be what -- what's this is  
15 requiring here.

16 MS. YEE: Okay, thank you, Mr. Davis.

17 Next speaker?

18 ---o0o---

19 JESSE MC CLELLAN

20 ---o0o---

21 MR. MC CLELLAN: Good afternoon, Jesse  
22 McClellan with Associated Sales Tax Consultants.

23 I also would like to commend the staff after  
24 reading the revised regulation. It looks like the  
25 majority of the language in there that was potentially  
26 damaging to taxpayers was removed or adjusted.

27 There does remain a couple of provisions within  
28 the regulation that I have concern with. From what I'm



1 gathering is it's the staff's intent, and also the  
2 Board's intent, to essentially allow the audit staff to  
3 have some leeway and use their professional discretion  
4 in what they're going to do.

5 If you look at C4, time of the audit, the  
6 language in that particular provision states that,  
7 "The auditor will schedule the audit without  
8 regard to the taxpayer or their  
9 representative."

10 I don't think that that's appropriate language  
11 to include in there. If you -- if you also look at the  
12 second paragraph of that same section, with respect to  
13 holding the audit in abeyance pending the completion of  
14 an Appeals conference, the staff added, "generally,"  
15 which is intended to provide some discretion there.

16 But the very next sentence says that,  
17 "The Board will begin the audit by examining  
18 areas that are not affected by the outcome of  
19 the appeal."

20 Clearly, that could be interpreted as the Board  
21 doesn't have to do the complete audit, but it will do  
22 the audit regardless of whether or not there is an  
23 appeal of a portion of the audit.

24 And I think what that's to going result in is  
25 really an inefficient use of the auditor's time, perhaps  
26 a waste of the taxpayer's time, and an appeal  
27 potentially could eliminate the need for a review of  
28 some of those areas.

1           And without allowing that potential to proceed,  
2           you essentially remove the opportunity to operate more  
3           efficiently.

4           The final issue that I have with the regulation  
5           deals with the location of the audit. The language  
6           states that the audit will not be transferred if there  
7           is any significant delay of the start of the completion.

8           The staff essentially responded to the issues  
9           raised by the interested parties that there's not an  
10          issue there because it's narrowly stated within the  
11          regulation. But I don't see that the language is  
12          narrow.

13          So, I would ask that the Board take a look at  
14          that particular language. Again, that's Section C1 of  
15          the regulation.

16          Thank you.

17          MS. YEE: Thank you very much.

18          MS. MANDEL: Maybe you're going to -- I just  
19          had two questions for them based on these last two  
20          speakers.

21          MS. YEE: Yeah, I was going to ask staff to try  
22          to address the concerns that Mr. McClellan has raised  
23          with respect to the location of the audit and then the  
24          provisions under subdivision C that he's enumerated.

25          MS. MANDEL: And can I just add mine on so you  
26          can address them all at once?

27          The question that Mr. Davis raised about  
28          commitment, if they pick an audit methodology is that --



1 does that mean that the taxpayer is forever bound by  
2 that audit methodology by signing the audit plan?

3 Is there some way that that's not and be made  
4 clear?

5 And on Mr. McClellan's on -- particularly on  
6 the C4, where you added the "generally" in the second  
7 paragraph to accommodate the concern that there might be  
8 some auditor who says, "I am not allowed to hold in  
9 abeyance," I do wonder whether the second sentence was  
10 not similarly, you know, revised.

11 You sort of stuck the "generally" and I was  
12 wondering if it ought to read something like,

13 "In cases where a prior audit is under appeal  
14 and the audit for the subsequent periods is not  
15 held in abeyance,"

16 Because it's not clear to me as he said, "It's  
17 not clear to me," as he said, did you mean -- you know,  
18 you're nodding.

19 I think you're understanding where I am, what  
20 I'm wondering, whether you just added the generally and  
21 neglected the second sentence and have a conflict?

22 MS. ORENDT: Well, actually, I the "generally,"  
23 I believe was there all along.

24 We added the second sentence and, yes, you're  
25 right. I believe that clarification should be made and  
26 the additional phrase, "in cases where the decision has  
27 been made."

28 It was -- the intent of that second sentence

1 was simply if there's a prior audit under appeal for a  
2 certain area, there is other areas that we can get  
3 started on.

4 MS. MANDEL: If you don't hold in abeyance?

5 MS. ORENDT: Correct.

6 MS. MANDEL: Okay. So, you --

7 MS. ORENDT: So, we need to add that additional  
8 phrase --

9 MS. MANDEL: -- need to clarify that.

10 MS. ORENDT: -- to second sentence. That would  
11 be helpful to clarify that.

12 MR. HORTON: What would you be afraid of?

13 MS. ORENDT: I can see now --

14 MS. YEE: Can you reiterate -- repeat that,  
15 Ms. Orendt?

16 MS. MANDEL: Well, what I wrote fastly was,  
17 "It currently says in cases where a prior audit  
18 is under appeal,"

19 And, so, I just added,

20 "And the audit for the subsequent periods is  
21 not held in abeyance."

22 But I wrote that really fast while he was  
23 talking.

24 MS. ORENDT: So, yeah, I don't know if we'll  
25 use that exact language, we'll come up with language to  
26 convey that message.

27 MS. MANDEL: Well, we're going to ask the -- if  
28 this goes forward, you are asking the Board to send it



1 to publication, so --

2 MS. YEE: Right.

3 MR. LEONARD: Yep.

4 MS. MANDEL: I guess you'll have to have --

5 MS. ORENDT: And the other change, I believe,  
6 that might accomplish the same is in cases --

7 MS. MANDEL: Then I'd like my language unless  
8 you come up with something faster by time this is going  
9 to be voted on.

10 MS. ORENDT: "The Board may begin," instead of  
11 "will."

12 I don't know if that -- that doesn't use  
13 language that is prescriptive in any --

14 MS. MANDEL: Well, no, you see, because now  
15 you've messed it up.

16 Because if you do not hold the subsequent audit  
17 in abeyance, I can tell you the taxpayers are going to  
18 want you to start with other stuff that you see in this  
19 particular period, not the stuff they currently have  
20 under appeal.

21 That's my guess. And they're all nodding yes.

22 MS. ORENDT: Right, right.

23 MS. MANDEL: So, you don't want to change the  
24 "will" to a "may," you just want to clarify that  
25 sentence, as I suggested, that it's only where you've  
26 got an appeal and you're not holding the subsequent  
27 audit --

28 MS. ORENDT: Right.

1 MS. MANDEL: -- in abeyance.

2 MS ORENDT: Right.

3 MS. MANDEL: So, just add that language.

4 MS. ORENDT: Okay.

5 MS. YEE: Okay.

6 MR. MC GUIRE: So, the sentence would read,  
7 "In the cases where a prior audit is under  
8 appeal and the audit for the subsequent period  
9 is not held in abeyance, the Board will begin  
10 the audit."?

11 MS. MANDEL: Correct.

12 MR. MC GUIRE: -- for the current?

13 MS. MANDEL: I think that deals with  
14 Mr. McClellan and then you probably want to address the  
15 rest of the --

16 MS. ORENDT: Okay. In cases where the  
17 location -- I believe it was C1, the last sentence of  
18 the first paragraph does go on to say,

19 "Requests will be granted unless Board staff  
20 determines the move will significantly delay  
21 the start or completion of the audit or if the  
22 Board does not have adequate resources  
23 available to conduct the audit at the requested  
24 location."

25 A few things come to mind as to the thinking  
26 behind the need for that sentence. First is, we do have  
27 limited resources in certain of our offices. And if, in  
28 fact, we have everyone wanting to get their audits done



1 in the San Diego office, we couldn't possibly do that.

2 Now, obviously, that's not going to happen,  
3 that everyone would want their audits done in the  
4 San Diego office. But if, in fact, they want it  
5 transferred somewhere and then they say they can't, we  
6 usually ask for a commitment that they're going to  
7 provide the records that we need, a verbal commitment.  
8 We may confirm that in writing.

9 Many times the taxpayer doesn't have those  
10 records and they won't allow them to leave. If they  
11 have a representative -- and I have an example where a  
12 representative is located in Florida -- but none of the  
13 original books and records are needed for an audit,  
14 either are there or will be moved there. So, we do want  
15 to take into consideration whether the requests are --  
16 the reason for the requests may be -- either may be or  
17 either result in a delay in starting or completing the  
18 audit.

19 I don't believe the language mandates anything.  
20 And, in fact, the first sentence does say,

21 "It will be granted."

22 And, generally, we do grant those requests.  
23 And generally, as long as they are reasonable, we would  
24 continue to do that.

25 So, I don't know if that addresses or if you're  
26 looking for specific language that you believe may  
27 alleviate specific --

28 MR. MC CLELLAN: Well, in the --

1 MS. ORENDT: -- specific concern.

2 MR. MC CLELLAN: -- the current language, in my  
3 opinion, is not narrow in scope, No. 1.

4 That was response to our initial issue with  
5 this particular section. You know, perhaps if it -- if  
6 a significant delay was defined?

7 So, in other words, if -- if you could say,  
8 look if it's going to take 60 days beyond the initial  
9 start date to begin this audit through the transfer,  
10 then that may be considered significant.

11 But another concern is with respect to the  
12 staff. You know, a taxpayer may have a representative,  
13 you know, out of state. I can see more concern there.  
14 I think there is a more valid concern there. But,  
15 obviously, we represent as a company, clients throughout  
16 the state.

17 And I think it's the taxpayer's right to hire  
18 who they -- who they want to. We, obviously, also have  
19 a district office that's very close to our office.

20 So, if there's a district that selects a  
21 particular audit and has an auditor ready to go, I mean,  
22 and get out there and start the work, really, the  
23 question is whether or not that audit would be permitted  
24 to be transferred if -- if the taxpayer were to assure  
25 that records are going to be made available and that we  
26 do everything on our part to make sure records are  
27 available and whether or not the taxpayer's rights to  
28 have that would be abridged by this section with no real



1 reason.

2 MS. ORENDT: We do have situations where there  
3 may be a tax representative and they may have many  
4 clients. And they -- they impede the progress or the  
5 start of the audit because they seem to only want or be  
6 able to handle a few audits at a time.

7 And when you have a backlog of audits where  
8 there is a representative -- a generic representative I  
9 am speaking of, not any particular one -- where you may  
10 have ten or twenty, it's not -- I mean, that's a real  
11 example, ten or twenty audits lined up and you can't  
12 start more than -- or work on more than one or two or  
13 three at a time, then that does impede our ability to  
14 start an audit. And it does delay, certainly, getting  
15 our work done.

16 So, the limitation on resources on either side  
17 may impede our ability to do the audits that are  
18 selected.

19 MR. MC CLELLAN: Well, and that obviously could  
20 be the case in the home district. And I don't  
21 necessarily see a problem in putting a requirement on a  
22 taxpayer to make records available timely. Obviously,  
23 that's part of the intent of this regulation here.

24 But to simply say that the Board may or may not  
25 transfer an audit when a taxpayer requests that it be  
26 transferred and be handled by a particular  
27 representative or at another office location because  
28 maybe that District office doesn't have an auditor

1 that's ready to go on that particular audit, even though  
2 the taxpayer is prepared to provide all of the records  
3 in a timely fashion.

4 It -- in its current state, it essentially  
5 gives the Board and the audit staff too much discretion  
6 to -- to deprive a taxpayer of the right to make that  
7 choice.

8 MS. YEE: Let's -- let me have staff respond to  
9 that.

10 I mean, is that really what's going to be the  
11 practical effect?

12 MS. ORENDT: I don't believe it is.

13 MS. YEE: I mean, I am having a hard time with  
14 this. I mean, if we're identifying a taxpayer for  
15 audit, I would hope that it's with the thought in mind  
16 that we have got resources, we're ready to go and we  
17 kind of know where that audit's going to take place.

18 And I really would hate to kind of do much to  
19 this -- to the language of this provision that narrows  
20 flexibility on both sides.

21 And -- but I just don't think on a practical  
22 level that that situation is going to occur that much.  
23 I actually see the situation Ms. Orendt has raised  
24 occurring much more frequently, where you have a  
25 representative who has got multiple taxpayers and the  
26 time allocated to each creates difficulties in terms of  
27 timing or when to start and get an audit completed.

28 But I think from a practical perspective, once



1 a taxpayer's been identified for audit, I think we're  
2 kind of ready to go at a particular location with  
3 particular resources available for that audit, yes?

4 MS. ORENDT: Correct. When we complete the  
5 audit selection, it is based on the resources available.  
6 And it's not assigned to an auditor until we have an  
7 auditor available to start that audit.

8 And then the point of contact -- that's the  
9 point of contact made with the taxpayer.

10 MS. YEE: And to your point, Mr. McClellan, I  
11 mean, the whole basis for my support for this regulation  
12 is our limited resources.

13 MR. MC CLELLAN: Uh-huh.

14 MS. YEE: And that -- I mean, I can't be  
15 any more clear about that.

16 I've heard from so many taxpayers about the  
17 length of time it takes to complete an audit. And what  
18 we've been trying to do in this regulation, I think  
19 we've tried to strike a good balance is to really  
20 lay out the expectations for all parties to an audit as  
21 to how to reach that goal.

22 And certainly the timely furnishing of records  
23 is a key part of that, but also as it relates to how  
24 we're going to consult with the taxpayer from the very  
25 beginning of this process, throughout the process and --  
26 as well as who we're going to involve, so, it's very  
27 clear from the outset where the roles and  
28 responsibilities are going to lie as well as the

1 expectations about time frames.

2 So, I mean going forward -- I don't expect this  
3 agency is going to be getting additional resources. And  
4 with the limited resources we've got, we're trying to  
5 figure out how to work smarter.

6 And the way that we're going to do that is by  
7 being very, very clear with taxpayers and our own staff  
8 internally about what's going to take place during the  
9 course of an audit and, hopefully, insure consistency  
10 among districts in terms of how audits will occur more  
11 timely.

12 So, I mean at this point I am -- I would hope  
13 that we would just allow the provision under subdivision  
14 1, location of the audit to see how that works.

15 But my sense is that we're not going to be  
16 identifying taxpayers for an audit if we don't feel like  
17 we're equipped with the resources to pursue those  
18 audits.

19 MR. MC CLELLAN: Which I understand. Of  
20 course, you're not initiating -- well, the auditor  
21 initiates contact with the taxpayer, generally to set up  
22 an appointment to set up a meeting to begin the audit.

23 The question is whether or not that taxpayer  
24 should have the right to choose their representative,  
25 even if their representative isn't located within the  
26 home district.

27 And, essentially, what I'm gathering is that  
28 the Board isn't necessarily interested -- or the staff,



1 I am sorry, isn't necessarily interested in whether or  
2 not the taxpayer wants to hire a representative outside  
3 of their district, but more interested in whether or not  
4 they have the immediate auditor ready to go to on the  
5 audit.

6 I don't think that that necessarily furthers  
7 the -- the intent of this regulation. Because if you  
8 end up with an adversarial audit from the get-go, it's  
9 going to slow the process. It's going to end up with  
10 more appeals of the audit.

11 So, again, if -- you know, if -- if what staff  
12 is saying is correct, that really this isn't going to  
13 come into play unless it really is problematic. And I  
14 recognize that there -- there needs to be some  
15 correction or some -- some more direction with respect  
16 to the audit process to increase efficiency. I think  
17 that's a very good idea.

18 But, again with the language as it stands, it  
19 potentially permits the staff to dictate whether or not  
20 a taxpayer may choose to transfer an audit.

21 MS. YEE: Mr. McClellan, we have no interest --  
22 I have no interest in really getting in the middle of a  
23 decision about who taxpayer decides to retain as a  
24 representative.

25 MR. MC CLELLAN: Okay.

26 MS. YEE: Okay. And I would hope that the  
27 staff is not interested in intervening in that kind of a  
28 decision.

1 MR. MC CLELLAN: You know what, I apologize.

2 MS. YEE: However --

3 MR. MC CLELLAN: Okay.

4 MS. YEE: -- if the situation occurs where  
5 there is a representative representing a taxpayer that  
6 has a location issue that affects the timely completion  
7 of an audit or undertaking of an audit, we're going to  
8 work with you on that.

9 MR. MC CLELLAN: Okay.

10 MS. YEE: Okay. I mean, we're interested in  
11 kind of getting it completed, as you -- as the taxpayer  
12 will be as well.

13 MR. MC CLELLAN: Sure.

14 MS, YEE: But I would just say, let's kind of  
15 leave the distrust behind us and allow this to work.  
16 We're trying to -- and what -- we're not here to try to  
17 impinge on taxpayer's rights, that's not the point.

18 The point is really, hopefully, to work with  
19 you. We know that audit -- time committed to audits is  
20 money on both sides.

21 And we really want to allow this reg to get  
22 into place so that we can -- with limited resources on  
23 all sides of an audit -- try to get to where we need to  
24 go.

25 Mr. Horton?

26 MR. HORTON: I agree with you, Madam Chair. I  
27 mean, I would only add that, you know, the capacity of  
28 the consultant is not necessarily a consideration of



1 whether or not there is adequate conference rooms or  
2 adequate staffing on the part of the consultant to  
3 address the number of clients that they may have.

4 I mean, that's a totally different decision  
5 that's being made by someone other than the Board of  
6 Equalization.

7 And I think that staff is appropriate -- is  
8 taking the appropriate action not to consider those  
9 factors. And that if they are, in fact, causing a  
10 delay, I think what we might want to do is encourage the  
11 consultant to hire more people or get a bigger office.

12 And this is not to be punitive, but delaying  
13 the audit because of those reasons just doesn't seem to  
14 have a lot of logic to me. I do believe that the  
15 taxpayer should be able to select whomever they want.  
16 They have that right. And that is in the best interests  
17 of the taxpayer to have the audit resolved as timely as  
18 possible. And it's generally in the best interests of  
19 the taxpayer to have the audit conducted where the audit  
20 records are, generally in the best interests.

21 It may not in the best interests of the  
22 consultants to have to travel to the taxpayer's office  
23 to work with the auditor. It may be more convenient for  
24 the consultant to have the records shipped to their  
25 location or maybe a better means for them to manage  
26 their client base. But I don't know if that is a  
27 consideration of the client or in the best interests of  
28 the client, the taxpayer or the Board of Equalization.

1 I would venture to say that if that discussion  
2 was made public, a client might have an issue with it.

3 So, I'm in concurrence with Madam Chair, I  
4 don't really see a reason why we should change this  
5 particular language.

6 MS. STEEL: Madam Chair?

7 MS. YEE: Ms. Steel and then --

8 MS. STEEL: I have a few concerns here for this  
9 regulation change.

10 First one that I heard from speakers were  
11 regarding that their one size fits all, it's not going  
12 to work for big companies comparing to small ones. And  
13 then there is very much bad language, it's totally  
14 open-ended for C4 that we've been talking about that --  
15 I don't think it -- I believe that it's a good policy to  
16 have multiple audits at the same time.

17 And then C7, that there is -- we give so much  
18 discretion to the auditors when the language represents  
19 as near the end of an audit or near the end doesn't mean  
20 it's not really clarifying for the taxpayers.

21 And then third one is future, every time we  
22 make this kind of regulations we may be adding penalty  
23 later on to taxpayers. So, it's going to get tougher  
24 and tougher. Seems like most regulations that we are  
25 changing, it gets really tougher for taxpayers to  
26 respond while going through the process.

27 So, I don't think this approach is really good  
28 and we really have to change the bad language first



1 before we vote for this change.

2 MS. YEE: Thank you, Ms. Steel.

3 Any other comments from the Members?

4 Mr. Davis, you had one final comment?

5 MR. DAVIS: Yeah, I just wanted to address what  
6 Mr. Horton said about the consultants being the cause of  
7 hanging up the auditors due to space requirements.

8 MR. HORTON: No, no, no.

9 MS. YEE: No, no, that's not what he said.

10 MR. DAVIS: Well, due to having too many  
11 clients and, you know, having to --

12 MR. HORTON: Let me -- let me clarify. Because  
13 that -- that may be what you understood me to say. So,  
14 out of respect to that, let me clarify.

15 If, in fact, that is the case, I think the  
16 premise for the statement is that we have to respect  
17 professional discretion in that both the auditor, as  
18 well as the taxpayer, should be in a position to  
19 exercise their professional discretion.

20 And on the part of the auditor, if, for  
21 example, part of the delay is attributed to those  
22 factors which I mentioned, the auditor should have the  
23 discretion to determine if that warrants a delay.

24 The taxpayer should have the discretion as well  
25 to determine if that warrants a delay. Because  
26 typically a delay in an audit to the taxpayer is  
27 additional interest, potential penalties. And, so, we  
28 would not want the taxpayer to incur that, if in the

1 professional judgment of the principals in this case,  
2 which happens to be the taxpayer, that the delay is  
3 attributed to the lack of space, the lack of staffing to  
4 address these issues currently or in a timely fashion.

5 I don't think anyone would want that to occur.  
6 In fact, if I was blessed with that problem, I would  
7 hire more people.

8 MR. DAVIS: And conceptually I have no argument  
9 with anything that you said.

10 I guess I'm concerned because I don't know of  
11 any consultants who are doing what you hypothecate  
12 there -- who are hanging up audits due to space  
13 requirements or inadequate staffing.

14 MR. HORTON: Neither -- and I don't want to go  
15 back and forth, Madam Chair.

16 MS. YEE: Yeah.

17 MR. HORTON: But this is a little different  
18 than the Assembly -- but neither do I, sir.

19 I mean -- and again, I mean, as I said from the  
20 onset is that I don't know that -- that we can -- we  
21 can -- we can -- on the existing law, under existing  
22 policy and procedures, we can do all of this currently.

23 What we're attempting to do, as I see it, is to  
24 codify an understanding of what we perceive to be  
25 efficient and, thus, the reason or the language,  
26 "generally, may, if this," and so forth.

27 But we're certainly not trying to impede the  
28 professional discretion or professional judgment, we



1 want to incorporate that somehow and maintain that.

2 There is no -- I mean, I understand and  
3 appreciate the fear. In fact, it was kind of  
4 interesting to see that that fear was driving a lot of  
5 the concern. But it doesn't appear that the elements  
6 relative to the fear exist any more.

7 And let me share as well, I think this -- we  
8 are trying to get at the exception. I think it is the  
9 consensus of the Board that the rule is that most of the  
10 taxpayers, the practitioners, do everything that they  
11 can humanly possibly do to protect the interests of  
12 their clients, in our case protect the interests of the  
13 State of California.

14 I think everyone's above board and generally  
15 honest. It is when you run into that exceptional  
16 situation where there is an unreasonable delay,  
17 generally speaking, if there is and if in the  
18 professional judgment of the Board, after notifying all  
19 of the parties why this delay exists, they're able to  
20 take certain actions that protects the taxpayer, this  
21 protects the taxpayer, plus it expedites the process and  
22 reduces the potential interest.

23 At that point, if there is issues not germane  
24 to the State of California or the taxpayer, I don't know  
25 that the professional ought to take those issues into  
26 consideration.

27 MS. YEE: Okay. Thank you very much,  
28 Mr. Horton.

1 Any other comments, Members?

2 Okay.

3 MR. LEONARD: Madam Chair?

4 MS. YEE: Yes, Mr. Leonard?

5 MR. LEONARD: Just to summarize my opinion,  
6 these aren't ready for prime time.

7 I first was intrigued because there was an  
8 allegation that tax -- certain taxpayers had organized  
9 in some kind of conspiracy to withhold data and to stall  
10 audits.

11 And in looking at our audit information, turns  
12 out not to be true. Certainly this is an adversarial  
13 proceeding to begin with, when an auditor comes in and  
14 says, "I don't believe you. I want to see all of your  
15 records."

16 I mean, that's -- they don't have to say it,  
17 that's what an audit's about. We want to make sure you  
18 honestly signed your return.

19 Without better -- to me the burden is on the  
20 Department to make some kind of case and no case has  
21 been made that there's a widespread act of misbehavior  
22 by taxpayers or their representatives which makes audits  
23 harder to do, more expensive, harder to get fair  
24 results.

25 Were that the case, then these regulations  
26 might be in order. It's a delicate balance of power. I  
27 think this Board is very good and the questions you've  
28 been asking today that reflect on that, that it -- it is



1 a delicate balance of power.

2 We do have the right and the duty to audit the  
3 taxpayer's records. We need to take advantage of that  
4 as appropriate.

5 Taxpayers have rights and responsibilities as  
6 well, including the rights from protection from  
7 harassment from their government.

8 At the best case, we know audits are expensive  
9 to the taxpayer. They're time consuming to us. And we  
10 need to select them in the best manner possible.

11 Miss Orendt, you made a misstatement, I'm  
12 going to say in advance you didn't mean this, but when  
13 you said that after a lengthy hot audit you hoped there  
14 was a liability after spending that much time on it, I  
15 know that's wrong. And you didn't really mean that.

16 Because that's not our goal. Our goal is a  
17 fair audit, whatever the number is, plus, minus or zero.  
18 We should be as concerned with refunds as we are with  
19 liabilities and that's hard to do. I mean, that is  
20 really tough.

21 And to -- for what extent we have now the audit  
22 manual as it's developed over the years, it seems to  
23 work. There are exceptions, that generally get appealed  
24 to here. There are other issues and each of our Board  
25 Members, like me, have intervened and tried to help the  
26 taxpayer get an auditor they can communicate with and  
27 call your staff to do that or ask Taxpayer Rights  
28 Advocate to help us out. Because there are exceptions

1 to that. But we should not govern by exceptions.

2 And my concern is is at this point, all we have  
3 is a few anecdotes. Now, we don't have proof or  
4 evidence to make the case. And it's just not ready.

5 MS. YEE: Thank you, Mr. Leonard.

6 I'm prepared to make a motion to approve and  
7 authorize for publication this -- the regulation before  
8 us.

9 I will say we've been talking about exceptions  
10 and extraordinary circumstances and I think that the  
11 exceptional situation that I see for us is really -- we  
12 are all working under very, very limited resources. And  
13 while much of this is really codifying existing  
14 practice, I think it does make clear how we intend to  
15 continue to do the work that we are charged to do under  
16 some pretty severe constraints.

17 So, with that, I will move to approve and  
18 authorize for publication proposed regulation -- the  
19 proposed regulation before us.

20 MS. MANDEL: With the -- with the amendment?

21 MS. YEE: Yes, with the amendment as you  
22 suggested, Ms. Mandel.

23 Is there a second?

24 MR. HORTON: Give me a second. I just want to  
25 read the claim for refund.

26 MS. YEE: Okay.

27 MR. HORTON: Madam Chair, if I may?

28 MS. YEE: Yes, Mr. Horton?



1 MR. HORTON: C7, let me first say I am actually  
2 okay with moving the regulation for the purpose of  
3 communicating to staff, giving them some direction on  
4 how to proceed to expedite the audit and, at the same  
5 time, maybe communicating to the taxpayers some  
6 expectations.

7 The claim for refund section, I really don't  
8 see the necessity for that. I just can't quite get  
9 there, Madam Chair, in that the Board -- the auditors  
10 should be doing this anyway.

11 They should be -- if they identify a claim for  
12 refund, they should be processing the claim for refund.  
13 There should be no implications that it should be  
14 delayed at all.

15 And even though this does not say it shall or  
16 should and so forth, the concern is is that it increases  
17 the probability. It modifies the culture or the thought  
18 process.

19 When, in fact, if it -- if it were the other  
20 way and we did an audit and there was a -- the audit  
21 resulted in a credit and the auditor -- the taxpayer  
22 brought something else up and it was a debit, I doubt if  
23 the auditor would say, "Well, let me finish this audit  
24 and issue you a credit and send you a check. We are  
25 going to deal with that debit later on."

26 Typically, you know, you want the sword to sort  
27 of cut both ways when you're talking about equity in  
28 your assessment and your legislative and regulatory

1 authority.

2 I would just ask that we discuss that aspect  
3 just a little more, Madam Chair. And I would really  
4 like to have your insight on this because you've been  
5 dealing with this a lot more than I have.

6 And let me preface that by saying that, you  
7 know, I would -- I would follow your judgment in that  
8 you have been dealing with this for a while.

9 MS. YEE: Well, first let me withdraw my motion  
10 for purposes of discussing this.

11 I guess from my perspective, if we were to  
12 remove this paragraph 7, I'm not sure that all much  
13 would change in the world in terms of practice.

14 I think if anything was really kind of a  
15 tickler so that during the course of the audit that we  
16 certainly want to give the opportunity for the taxpayer  
17 to come forward with respect to any claims for refunds  
18 to the effect -- to the extent that, as Ms. Orendt had  
19 commented, we can give effect to any credits that might  
20 be appropriate.

21 So, if we were to remove the provision, I'm not  
22 so sure that it would harm anything. It's just  
23 something that's really -- I mean, in my mind it was  
24 really more kind of a tickler during the course of the  
25 audit as one -- one issue to bear in mind.

26 So, I could live either way.

27 MR. HORTON: Madam Chair, if I may?

28 MS. YEE: Yes?



1 MR. HORTON: We might be able to accomplish the  
2 goal of communicating to staff by striking the last  
3 sentence,

4 "A claim for refund that is presented near the  
5 conclusion of the audit may be addressed  
6 separately."

7 Leave that to the discretion of the taxpayer  
8 and the discretion of the auditor.

9 I think personally they should address it  
10 concurrently. I think we've got issues with debit and  
11 credit interest and offsetting.

12 I think we have accounting issues of, you know,  
13 having the FBO filed subsequently and then having to  
14 consolidate the two. That's just very, very -- can be  
15 very, very complicated not that efficient.

16 I like the adjustment the judgment made to C4.

17 And I think C1 is right on the mark. So --

18 MS. YEE: Okay, Mr. Horton, I -- Ms. Mandel?

19 MS. MANDEL: Can I just -- you know, I have --  
20 I kind of have a rule when I look at these things of,  
21 you know, what -- what's going to happen when we're --  
22 when no one's here any more that worked on it?

23 MR. LEONARD: You'll have to stay.

24 You've been here a while.

25 MS. MANDEL: Well, I've been here a while, but,  
26 you know, we sit in these meetings sometimes and, you  
27 know, you hear Legal say, "Well, that would never happen  
28 at audit. The auditor would never do that."

1           And then the taxpayers say, "Oh, yeah, but the  
2           auditors do that."

3           So, if that sentence is struck, I'm just  
4           curious about the "should present," whether some, you  
5           know, auditor is going to say, "You didn't present it or  
6           I'm not even going to, you know, send it anywhere."

7           And maybe if it gets added at the end of that  
8           sentence, it's just in order to facilitate timely  
9           something.

10          MR. HORTON: Yeah, that makes sense.

11          MS. MANDEL: But we need the something. Let's  
12          see --

13          MS. ORENDT: Well, I wanted to point out that  
14          in the paragraph above, No. 6, Opening Conference, we do  
15          spell out during the opening conference items to be  
16          discussed, include, not limited to, claims for refund is  
17          included.

18          MR. HORTON: Yeah, it's on there.

19          MS. ORENDT: It is included in this.

20          And my opinion, perhaps if you wanted to  
21          include -- include anything in that, maybe,

22          "Auditor should encourage the taxpayer to  
23          present claims for refund at the beginning of  
24          the audit."

25          MR. HORTON: Yeah.

26          MS. ORENDT: But it is covered specifically as  
27          a topic of discussion that the auditor should cover in  
28          the opening conference.



1 MR. HORTON: One of those little checkmarks.

2 MS. YEE: Right, exactly.

3 MR. HORTON: We check it off.

4 MS. YEE: So, we either -- so, either we try to  
5 modify paragraph 7, as suggested by Ms. Mandel, or maybe  
6 delete?

7 MS. ORENDT: Delete it in its entirety, yes.

8 MS. YEE: Yeah.

9 MS. ORENDT: Yes.

10 MS. YEE: To really give us --

11 MS. ORENDT: Staff is okay with that.

12 MS. YEE: So, deleting all of paragraph 7 --

13 MS. MANDEL: Okay.

14 MS. YEE: -- since it is included as a topic  
15 for the opening conference, in paragraph 6, okay.

16 And that way we're not trying to put  
17 ourselves -- okay.

18 All right. So, we have then the regulation  
19 before us. Let me remake my motion to approve and  
20 authorize for publication the proposed regulation with  
21 the suggested revision to --

22 MS. MANDEL: Second paragraph of C4.

23 MS. YEE: -- right, the second paragraph of C4  
24 and with the deletion of paragraph 7 under subdivision  
25 C.

26 Okay, is there a second?

27 MR. HORTON: Second.

28 MS. YEE: Second by Mr. Horton.

1 Discussion?

2 Please call the roll.

3 MS. RICHMOND: Madam Chair?

4 MS. YEE: Aye.

5 MS. RICHMOND: Mr. Leonard?

6 MR. LEONARD: No.

7 MS. RICHMOND: Ms. Steel?

8 MS. STEEL: No.

9 MS. RICHMOND: Mr. Horton?

10 MR. HORTON: Aye.

11 MS. RICHMOND: Ms. Mandel?

12 MS. MANDEL: Aye.

13 MS. RICHMOND: Motion carries.

14 MS. YEE: Thank you very much, Members. And  
15 thank you, staff, for your continued work with the  
16 interested parties.

17 And to the interested parties, thank you much  
18 for all your diligence and patience with this.

19 We will recess until 1:30, reconvene at that  
20 time.

21 Thank you.

22 ---o0o---

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28

## REPORTER'S CERTIFICATE

State of California     )  
                                  )  ss  
County of Sacramento    )

I, JULI PRICE JACKSON, Hearing Reporter for the California State Board of Equalization certify that on NOVEMBER 17, 2009 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 67 constitute a complete and accurate transcription of the shorthand writing.

Dated:  December 23, 2009

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JULI PRICE JACKSON  
Hearing Reporter



**ESTIMATE OF COST OR SAVINGS RESULTING  
FROM PROPOSED REGULATORY ACTION**

**Proposed Amendment of Sales and Use Tax Regulation 1698.5, *Audit Procedures***

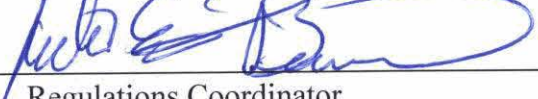
**STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING**

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement  
Prepared by  Date 1-6-2010  
Regulations Coordinator

Approved by  Date 1/14/10  
Chief Counsel

**If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required**

Approved by \_\_\_\_\_ Date \_\_\_\_\_  
Chief, Financial Management Division

Approved by \_\_\_\_\_ Date \_\_\_\_\_  
Chief, Board Proceedings Division

**NOTE: SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.**

**ECONOMIC AND FISCAL IMPACT STATEMENT****(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2008)

*See SAM Section 6601 - 6616 for Instructions and Code Citations*

DEPARTMENT NAME State Board of Equalization	CONTACT PERSON Rick Bennion	TELEPHONE NUMBER 916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400 Title 18, Section 1698.5, Audit Procedures		NOTICE FILE NUMBER Z

**ECONOMIC IMPACT STATEMENT****A. ESTIMATED PRIVATE SECTOR COST IMPACTS** (Include calculations and assumptions in the rulemaking record.)

1. Check the appropriate box(es) below to indicate whether this regulation:

- |   |  |
|---|--|
| <input type="checkbox"/> a. Impacts businesses and/or employees | <input type="checkbox"/> e. Imposes reporting requirements   |
| <input type="checkbox"/> b. Impacts small businesses            | <input type="checkbox"/> f. Imposes prescriptive instead of performance  |
| <input type="checkbox"/> c. Impacts jobs or occupations         | <input type="checkbox"/> g. Impacts individuals  |
| <input type="checkbox"/> d. Impacts California competitiveness  | <input checked="" type="checkbox"/> h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.) |

h. (cont.) No significant adverse economic impact on business or employees, small business, jobs or occupations.

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: \_\_\_\_\_ Describe the types of businesses (Include nonprofits.): \_\_\_\_\_

Enter the number or percentage of total businesses impacted that are small businesses: \_\_\_\_\_

Enter the number of businesses that will be created: \_\_\_\_\_ eliminated: \_\_\_\_\_

Explain: \_\_\_\_\_

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): \_\_\_\_\_

5. Enter the number of jobs created: \_\_\_\_\_ or eliminated: \_\_\_\_\_ Describe the types of jobs or occupations impacted: \_\_\_\_\_

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: \_\_\_\_\_**B. ESTIMATED COSTS** (Include calculations and assumptions in the rulemaking record.)

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? \$ \_\_\_\_\_

a. Initial costs for a small business: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

b. Initial costs for a typical business: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

c. Initial costs for an individual: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

Describe other economic costs that may occur: \_\_\_\_\_



**ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)**

2. If multiple industries are impacted, enter the share of total costs for each industry: \_\_\_\_\_

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): \$ \_\_\_\_\_

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: \_\_\_\_\_ and the number of units: \_\_\_\_\_

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: \_\_\_\_\_

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: \$ \_\_\_\_\_

**C. ESTIMATED BENEFITS** (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: \_\_\_\_\_

2. Are the benefits the result of : ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: \_\_\_\_\_

3. What are the total statewide benefits from this regulation over its lifetime? \$ \_\_\_\_\_

**D. ALTERNATIVES TO THE REGULATION** (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: \_\_\_\_\_

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: \$ _____	Cost: \$ _____
Alternative 1:	Benefit: \$ _____	Cost: \$ _____
Alternative 2:	Benefit: \$ _____	Cost: \$ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: \_\_\_\_\_

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

Explain: \_\_\_\_\_

**E. MAJOR REGULATIONS** (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.



**ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)**

1. Will the estimated costs of this regulation to California business enterprises exceed \$10 million ? ☐ Yes ☐ No (If No, skip the rest of this section.)

2. Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: \_\_\_\_\_

Alternative 2: \_\_\_\_\_

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation: \$ \_\_\_\_\_ Cost-effectiveness ratio: \$ \_\_\_\_\_

Alternative 1: \$ \_\_\_\_\_ Cost-effectiveness ratio: \$ \_\_\_\_\_

Alternative 2: \$ \_\_\_\_\_ Cost-effectiveness ratio: \$ \_\_\_\_\_

**FISCAL IMPACT STATEMENT**

A. FISCAL EFFECT ON LOCAL GOVERNMENT (Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in \_\_\_\_\_, Budget Act of \_\_\_\_\_ or Chapter \_\_\_\_\_, Statutes of \_\_\_\_\_

☐ b. will be requested in the \_\_\_\_\_ Governor's Budget for appropriation in Budget Act of \_\_\_\_\_  
(FISCAL YEAR)

☐ 2. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in \_\_\_\_\_

☐ b. implements the court mandate set forth by the \_\_\_\_\_  
court in the case of \_\_\_\_\_ vs. \_\_\_\_\_

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. \_\_\_\_\_ at the \_\_\_\_\_  
election; (DATE)

☐ d. is issued only in response to a specific request from the \_\_\_\_\_  
\_\_\_\_\_, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the \_\_\_\_\_ authorized by Section \_\_\_\_\_  
(FEES, REVENUE, ETC.)  
\_\_\_\_\_ of the \_\_\_\_\_ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in \_\_\_\_\_

☐ 3. Savings of approximately \$ \_\_\_\_\_ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.

**ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 2-98)**

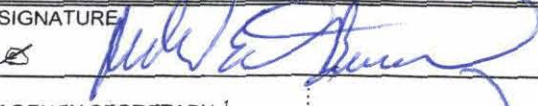

- ☒ 5. No fiscal impact exists because this regulation does not affect any local entity or program.
- ☐ 6. Other.

**B. FISCAL EFFECT ON STATE GOVERNMENT** (Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

- ☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year. It is anticipated that State agencies will:
- ☐ a. be able to absorb these additional costs within their existing budgets and resources.
- ☐ b. request an increase in the currently authorized budget level for the \_\_\_\_\_ fiscal year.
- ☐ 2. Savings of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☒ 3. No fiscal impact exists because this regulation does not affect any State agency or program.
- ☐ 4. Other.

**C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS** (Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

- ☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☐ 2. Savings of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☒ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.
- ☐ 4. Other.

SIGNATURE 		TITLE Regulations Coordinator
AGENCY SECRETARY <sup>1</sup>		DATE 1/5/10
APPROVAL/CONCURRENCE	PROGRAM BUDGET MANAGER	DATE
DEPARTMENT OF FINANCE <sup>2</sup>	Exempt under SAM section 6660	
APPROVAL/CONCURRENCE		

1. The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.
2. Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.



**NOTICE PUBLICATION/REGULATIONS SUBMISSION**(See instructions on  
reverse)

For use by Secretary of State only

STD. 400 (REV. 01-09)

<b>OAL FILE NUMBERS</b>	NOTICE FILE NUMBER <b>Z-2010-0105-03</b>	REGULATORY ACTION NUMBER	EMERGENCY NUMBER
For use by Office of Administrative Law (OAL) only			
<b>RECEIVED FOR FILING PUBLICATION DATE</b>  <b>JAN 05 '10      JAN 15 '10</b>  <b>Office of Administrative Law</b>			
<b>NOTICE</b>		<b>REGULATIONS</b>	

AGENCY WITH RULEMAKING AUTHORITY  
State Board of Equalization

AGENCY FILE NUMBER (If any)

**A. PUBLICATION OF NOTICE (Complete for publication in Notice Register)**

1. SUBJECT OF NOTICE <b>Audit Procedures</b>		TITLE(S) <b>18</b>	FIRST SECTION AFFECTED <b>1698.5</b>	2. REQUESTED PUBLICATION DATE <b>1/15/2010</b>
3. NOTICE TYPE <input checked="" type="checkbox"/> Notice re Proposed Regulatory Action <input type="checkbox"/> Other		4. AGENCY CONTACT PERSON <b>Richard E. Bennion</b>	TELEPHONE NUMBER <b>(916) 445-2130</b>	FAX NUMBER (Optional) <b>(916) 324-3984</b>
<b>OAL USE ONLY</b>	ACTION ON PROPOSED NOTICE <input type="checkbox"/> Approved as Submitted <input type="checkbox"/> Approved as Modified <input type="checkbox"/> Disapproved/Withdrawn		NOTICE REGISTER NUMBER	PUBLICATION DATE

**B. SUBMISSION OF REGULATIONS (Complete when submitting regulations)**

1a. SUBJECT OF REGULATION(S)		1b. ALL PREVIOUS RELATED OAL REGULATORY ACTION NUMBER(S)	
2. SPECIFY CALIFORNIA CODE OF REGULATIONS TITLE(S) AND SECTION(S) (Including title 26, if toxics related)			
<b>SECTION(S) AFFECTED</b> <b>(List all section number(s) individually. Attach additional sheet if needed.)</b>  TITLE(S)	ADOPT		
	AMEND		
	REPEAL		
3. TYPE OF FILING			
<input type="checkbox"/> Regular Rulemaking (Gov. Code §11346) <input type="checkbox"/> Resubmittal of disapproved or withdrawn nonemergency filing (Gov. Code §§11349.3, 11349.4) <input type="checkbox"/> Emergency (Gov. Code, §11346.1(b))			
<input type="checkbox"/> Certificate of Compliance: The agency officer named below certifies that this agency complied with the provisions of Gov. Code §§11346.2-11347.3 either before the emergency regulation was adopted or within the time period required by statute. <input type="checkbox"/> Resubmittal of disapproved or withdrawn emergency filing (Gov. Code, §11346.1)			
<input type="checkbox"/> Emergency Readopt (Gov. Code, §11346.1(h)) <input type="checkbox"/> File & Print <input type="checkbox"/> Other (Specify) _____			
<input type="checkbox"/> Changes Without Regulatory Effect (Cal. Code Regs., title 1, §100) <input type="checkbox"/> Print Only			
4. ALL BEGINNING AND ENDING DATES OF AVAILABILITY OF MODIFIED REGULATIONS AND/OR MATERIAL ADDED TO THE RULEMAKING FILE (Cal. Code Regs. title 1, §44 and Gov. Code §11347.1)			
5. EFFECTIVE DATE OF CHANGES (Gov. Code, §§ 11343.4, 11346.1(d); Cal. Code Regs., title 1, §100)			
<input type="checkbox"/> Effective 30th day after filing with Secretary of State <input type="checkbox"/> Effective on filing with Secretary of State <input type="checkbox"/> §100 Changes Without Regulatory Effect <input type="checkbox"/> Effective other (Specify) _____			
6. CHECK IF THESE REGULATIONS REQUIRE NOTICE TO, OR REVIEW, CONSULTATION, APPROVAL OR CONCURRENCE BY, ANOTHER AGENCY OR ENTITY			
<input type="checkbox"/> Department of Finance (Form STD. 399) (SAM §6660) <input type="checkbox"/> Fair Political Practices Commission <input type="checkbox"/> State Fire Marshal <input type="checkbox"/> Other (Specify) _____			
7. CONTACT PERSON	TELEPHONE NUMBER	FAX NUMBER (Optional)	E-MAIL ADDRESS (Optional)

8. **I certify that the attached copy of the regulation(s) is a true and correct copy of the regulation(s) identified on this form, that the information specified on this form is true and correct, and that I am the head of the agency taking this action, or a designee of the head of the agency, and am authorized to make this certification.**

For use by Office of Administrative Law (OAL) only

SIGNATURE OF AGENCY HEAD OR DESIGNEE

DATE

TYPED NAME AND TITLE OF SIGNATORY



## **Notice of Proposed Regulatory Action**

### **The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1698.5, *Audit Procedures***

#### **NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2009. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation. In addition, if the Board receives written comments prior to the hearing on March 23, 2009, the statements, arguments, and/or contentions contained in those comments will be presented to and considered by the Board before the Board decides whether to adopt the proposed regulation.

#### **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

##### **Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.



The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

### **Proposed Regulation**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary.

Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

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<sup>1</sup> The Board's Audit Manual is available at <http://www.boe.ca.gov/sutax/staxmanuals.htm>.



Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.

There are no comparable federal regulations or statutes to proposed Regulation 1698.5.

#### **NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

#### **NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 will result in no direct or indirect cost or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under part 7 (commencing



with section 17500) of division 4 of title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

### **NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Therefore, the Board has made an initial determination that proposed Regulation 1698.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The proposed regulation may affect small business.

### **NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

### **RESULTS OF THE ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the adoption of proposed Regulation 1698.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

### **NO SIGNIFICANT EFFECT ON HOUSING COSTS**

Adoption of proposed Regulation 1698.5 will not have a significant effect on housing costs.

### **DETERMINATION REGARDING ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective as and less burdensome to affected private persons than the proposed action.

## **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## **AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 1698.5 showing its express terms. These documents and all information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the Initial Statement of Reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

## **SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt proposed Regulation 1698.5 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

## **AVAILABILITY OF FINAL STATEMENT OF REASONS**

If the Board adopts proposed Regulation 1698.5, the Board will prepare a Final Statement of Reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).



**Proposed Text of California Code of Regulations,  
Title 18, Section 1698.5**

**1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

(1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.

(2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.

(3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.

(4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.

(5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.

(6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.

(7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.

(8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.

(9) DAY. For the purposes of this regulation, "day" means calendar day.



**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.



(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.



(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

**(c) Audits.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A taxpayer's request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.



(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.



As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.

**Bennion, Richard**

**From:** BOE-Board Meeting Material

**Sent:** Friday, January 15, 2010 12:10 PM

**To:** 'jene.bernard@thomsonreuters.com'; 'dbesio@frk.com'; 'richard.Boehmer@tema.toyota.com'; 'Jana.Bohlman@safeway.com'; 'William.Carter@safeway.com'; 'Linda.Childers@BNSF.com'; 'kyla@calchamber.com'; 'john.cmelak@verizonwireless.com'; 'Jan.K.Couture@supervalu.com'; 'mdickson@ipt.org'; 'rdyer@na.ko.com'; 'john\_evans2@hp.com'; 'patrick.guerin@ge.com'; 'mphart@amgen.com'; 'clark.hemingway@ge.com'; 'ferdinand.hogroian@us.pwc.com'; 'mary\_kanzaki@agilent.com'; 'RKroha@ciber.com'; 'Jleslie@cost.org'; 'james.b.levinson@us.pwc.com'; 'michael.mccrary@purina.nestle.com'; 'cmckowen@ASTC.com'; 'david.meier@tema.toyota.com'; 'KNienhaus@ciber.com'; 'spol@chevron.com'; 'Felicita.Peters@safeway.com'; 'michael.prosio@gov.ca.gov'; 'fairvalue@earthlink.net'; 'Debra.Reeves@valero.com'; 'gus.rivera@intel.com'; 'Neil.scott1@safeway.com'; 'suhair.shabazz@bankofamerica.com'; 'esiedentopf@costco.com'; 'james.speed@thompson-tax.com'; 'william.taylor@ge.com'; 'MThornton@JHCohn.com'; 'gary.toussaint@transammonia.com'; 'jeff.troyer@ge.com'; 'mwang@wspa.org'; 'eric.d.wojinski@fritolay.com'; 'denise.o.ruwe@exxonmobil.com'

**Cc:** Olson, Diane; Hellmuth, Leila; Bennion, Richard

**Subject:** State Board of Equalization - Announcement of Regulatory Change

The State Board of Equalization will hold a public hearing to consider the adoption of Sales and Use Tax Regulation 1698.5, Audit Procedures. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The public hearing on the proposed regulation will be held in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on Tuesday, March 23, 2010.

To view the notice of hearing, initial statement of reasons, proposed text, and history click on the following link:

[www.boe.ca.gov/regs/reg1698\\_5.htm](http://www.boe.ca.gov/regs/reg1698_5.htm).

Questions regarding the substance of the proposed amendments to Regulation 1698.5 should be directed to: Mr. Bradley Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed regulatory action should be directed to Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov) or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879, Sacramento, CA 94279-0080.



at [www.ctc.ca.gov](http://www.ctc.ca.gov) or you may obtain a copy by contacting Tammy A. Duggan at (916) 323-5354.

**Availability of Documents on the Internet**

Copies of the Notice of Proposed Action, the Initial Statement of Reasons and the text of the regulations in underline and strikeout may be accessed through the Commission's website at [www.ctc.ca.gov](http://www.ctc.ca.gov).

**TITLE 18. BOARD OF EQUALIZATION**

**Notice of Proposed Regulatory Action**

**The State Board of Equalization Proposes to Adopt California Code of Regulations, Title 18, Section 1698.5, *Audit Procedures***

**NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2009. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation. In addition, if the Board receives written comments prior to the hearing on March 23, 2009, the statements, arguments, and/or contentions contained in those comments will be presented to and considered by the Board before the Board decides whether to adopt the proposed regulation.

**INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

**Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

**Proposed Regulation**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the be-

<sup>1</sup> The Board's Audit Manual is available at [www.boe.ca.gov/sutax/staxmanuals.htm](http://www.boe.ca.gov/sutax/staxmanuals.htm).



ginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.

There are no comparable federal regulations or statutes to proposed Regulation 1698.5.

#### NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

#### NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that proposed Regulation 1698.5 will result in no direct or indirect cost or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

#### NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Therefore, the Board has made an initial determination that proposed Regulation 1698.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The proposed regulation may affect small business.

#### NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

#### RESULTS OF THE ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has determined that the adoption of proposed Regulation 1698.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.



# NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of proposed Regulation 1698.5 will not have a significant effect on housing costs.

## DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective as and less burdensome to affected private persons than the proposed action.

## CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 1698.5 showing its express terms. These documents and all information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the Initial Statement of Reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

## SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 1698.5 with changes that are nonsubstantial or solely grammat-

ical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

## AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 1698.5, the Board will prepare a Final Statement of Reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

# GENERAL PUBLIC INTEREST

## CORRECTIONS STANDARDS AUTHORITY

## NOTICE OF EXTENDED PUBLIC COMMENT PERIOD AND RESCHEDULED PUBLIC HEARING

**California Code of Regulations  
Title 15, Crime Prevention and Corrections  
Department of Corrections and Rehabilitation  
Corrections Standards Authority**

## EXTENSION OF PUBLIC COMMENT PERIOD

The Corrections Standards Authority (CSA) is amending the 2007 Local Jail Construction Funding Program regulations (Title 15, California Code of Regulations, Division 1, Chapter 1, Subchapter 6).

CSA originally published its full-length notice in the California Regulatory Notice Register on December 4, 2009, Register 2009, No. 49-Z, page 2068.

The public comment period opened on **December 4, 2009** and was to have closed on January 26, 2010 at 5:00 p.m. In order to assure that sufficient notice has been





STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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Third District, Rolling Hills Estates

JEROME E. HORTON  
Fourth District, Los Angeles

JOHN CHIANG  
State Controller

RAMON J. HIRSIG  
Executive Director

**January 15, 2010**

**To Interested Parties:**

**Notice of Proposed Regulatory Action  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

**NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2009. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation. In addition, if the Board receives written comments prior to the hearing on March 23, 2009, the statements, arguments, and/or contentions contained in those comments will be presented to and considered by the Board before the Board decides whether to adopt the proposed regulation.

## **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

### **Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

### **Proposed Regulation**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit

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a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.



There are no comparable federal regulations or statutes to proposed Regulation 1698.5.

#### **NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

#### **NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 will result in no direct or indirect cost or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

#### **NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Therefore, the Board has made an initial determination that proposed Regulation 1698.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The proposed regulation may affect small business.

#### **NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

#### **RESULTS OF THE ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the adoption of proposed Regulation 1698.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.



## **NO SIGNIFICANT EFFECT ON HOUSING COSTS**

Adoption of proposed Regulation 1698.5 will not have a significant effect on housing costs.

## **DETERMINATION REGARDING ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective as and less burdensome to affected private persons than the proposed action.

## **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## **AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 1698.5 showing its express terms. These documents and all information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the Initial Statement of Reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

## **SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt proposed Regulation 1698.5 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the

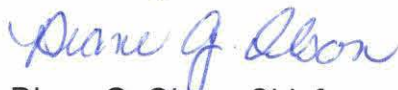
January 15, 2010

originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

#### **AVAILABILITY OF FINAL STATEMENT OF REASONS**

If the Board adopts proposed Regulation 1698.5, the Board will prepare a Final Statement of Reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

Sincerely,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures



## **Initial Statement of Reasons**

### **Proposed Adoption of California Code of Regulations, Title 18, Section 1698.5, *Audit Procedures***

#### **SPECIFIC PURPOSE AND NECESSITY**

Revenue and Taxation Code section (section) 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require. Section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits. Therefore, the Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation.

Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day." Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request.

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Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

Proposed regulation 1698.5 is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.



## **DOCUMENTS RELIED UPON**

The Board relied upon Formal Issue Paper 09-005 (November 2, 2009) and comments from interested parties and Board staff made during the Board's November 17, 2009, Business Taxes Committee meeting in deciding to propose the adoption of Regulation 1698.5. Issue Paper 09-005 is available on the Board's Website at [www.boe.ca.gov/meetings/pdf/Combined\\_1698.5.pdf](http://www.boe.ca.gov/meetings/pdf/Combined_1698.5.pdf). The audio and video from the November 17, 2009, Business Taxes Committee meeting is available on the Board's Website at [www.visualwebcaster.com/event.asp?id=53985](http://www.visualwebcaster.com/event.asp?id=53985). The minutes from the November 17, 2009, Business Taxes Committee meeting are available on the Board's Website at [www.boe.ca.gov/meetings/pdf/111709-Board\\_committee\\_minutes.pdf](http://www.boe.ca.gov/meetings/pdf/111709-Board_committee_minutes.pdf).

## **ALTERNATIVES CONSIDERED**

The Board considered whether it would be more appropriate to take no action as an alternative to adopting proposed Regulation 1698.5, during the Board's November 17, 2009, Business Taxes Committee meeting. The Board decided to propose the adoption of Regulation 1698.5 because the regulation is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.

## **NO ADVERSE ECONOMIC IMPACT ON BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Furthermore, proposed Regulation 1698.5, subdivision (c)(4), expressly provides that "the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects." Therefore, the Board has determined that the proposed regulation will not have a significant adverse economic impact on business.

**Proposed Text of California Code of Regulations,  
Title 18, Section 1698.5**

**1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (9) DAY. For the purposes of this regulation, "day" means calendar day.



**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.



(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.



(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

**(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.



(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.



(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.



As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.



## Regulation History

**Type of Regulation:** Sales and Use Tax

Regulation: 1698.5

Title: 1698.5, *Audit Procedures*

**Preparation:** Brad Heller

**Legal Contact:** Brad Heller

Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation.

### History of Proposed Regulation:

March 23, 2010	Public hearing
March 1, 2010	45-day public comment period ends
January 15, 2010	OAL publication date; 45-day public comment period begins; IP mailing
January 5, 2010	Notice to OAL
November 17, 2009	Business Tax Committee, Board Authorized Publication (vote 5 -0)

Sponsor: NA

Support: NA

Oppose: NA

## The State Board of Equalization

### NOTICE OF CORRECTION

The State Board of Equalization published a Notice of Proposed Regulatory Action (NOPRA) concerning the proposed adoption of California Code of Regulations, title 18, section (Regulation) 1698.5, Audit Procedures, in the January 15, 2010, edition of the California Regulatory Notice Register (Register 2010, No. 3-Z, Page 89). The second paragraph of the published NOPRA contained a typographical error, which incorrectly indicated that the public hearing regarding the proposed regulatory action was scheduled for March 23, 2009, and that the deadline for the Board to receive written comments was prior to the start of the 2009 hearing. The NOPRA should have correctly provided that:

"A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation."

"Any interested person may also submit written comments regarding the adoption of the proposed regulation. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation."

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.



stone, Tax, Counsel III (Specialist), by telephone at (916) 323-7713, by e-mail at [Carolee.Johnstone@boe.ca.gov](mailto:Carolee.Johnstone@boe.ca.gov), or by mail at State Board of Equalization, Attn: Carolee D. Johnstone, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

#### AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 4903 and the proposed cross-referencing regulations showing their express terms. These documents and all information on which the proposed regulations are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the Initial Statement of Reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

#### SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt proposed Regulation 4903 and the proposed cross-referencing regulations with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made to a proposed regulation, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

#### AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts proposed Regulation 4903 and the proposed cross-referencing regulations, the Board will prepare a Final Statement of Reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

### GENERAL PUBLIC INTEREST

#### BOARD OF EQUALIZATION

#### NOTICE OF CORRECTION

##### Concerning the Board of Equalization's Notice of Proposed Action

The State Board of Equalization published a Notice of Proposed Regulatory Action (NOPRA) concerning the proposed adoption of California Code of Regulations, title 18, section (Regulation) 1698.5, Audit Procedures, in the January 15, 2010, edition of the California Regulatory Notice Register (Register 2010, No. 3-Z, Page 89). The second paragraph of the published NOPRA contained a typographical error, which incorrectly indicated that the public hearing regarding the proposed regulatory action was scheduled for March 23, 2009, and that the deadline for the Board to receive written comments was prior to the start of the 2009 hearing. The NOPRA should have correctly provided that:

"A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation."

"Any interested person may also submit written comments regarding the adoption of the proposed regulation. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation."

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Acting Regulations Coordi-



nator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## PROPOSITION 65

### OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT

### CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT

### SAFE DRINKING WATER AND TOXIC ENFORCEMENT ACT OF 1986 (PROPOSITION 65)

### NOTICE OF INTENT TO LIST SPIRODICLOFEN EXTENSION OF PUBLIC COMMENT PERIOD January 22, 2010

[Posted on OEHHA web site on January 7, 2010]

The Safe Drinking Water and Toxic Enforcement Act of 1986 (Proposition 65 or the Act), which is codified as Health and Safety Code section 25249.5 et seq., requires the Governor to publish, and update at least annually, a list of chemicals known to the State to cause cancer or reproductive toxicity. The Act describes the mechanisms for administratively listing chemicals as known to the State to cause cancer or reproductive toxicity (Health and Safety Code section 25249.8).

On November 27, 2009, OEHHA published a notice in the *California Regulatory Notice Register* (Register 2009, No. 48-Z) soliciting information which may be relevant to the evaluation of *spirodiclofen* under consideration for possible listing within the context of the Proposition 65 administrative listing regulatory criteria in Title 27 of the California Code of Regulations section 25306 (formerly Title 22 of the California Code of Regulations section 12306.)

The publication of the notice initiated a 30-day public comment period which would have closed on January 11, 2010. OEHHA has received a request from an interested party seeking an extension of the comment period to allow for the submission of complete and relevant scientific information for *spirodiclofen*. **OEHHA hereby extends the public comment period for *spirodiclofen* to 5 p.m., Monday, January 25, 2010.**

Written comments, along with any supporting documentation, may be transmitted via email addressed to [coshita@oehha.ca.gov](mailto:coshita@oehha.ca.gov) or to:

Ms. Cynthia Oshita  
Office of Environmental Health Hazard Assessment  
Street Address: 1001 I Street, 19<sup>th</sup> floor  
Sacramento, California 95814  
Mailing Address: P.O. Box 4010  
Sacramento, California 95812-4010  
Fax No.: (916) 323-8803  
Telephone: (916) 445-6900

It is requested that hard-copy comments be submitted in triplicate. **In order to be considered, comments must be received at OEHHA by 5:00 p.m. Monday, January 25, 2010.**

## AVAILABILITY OF INDEX OF PRECEDENTIAL DECISIONS

### VICTIM COMPENSATION AND GOVERNMENT CLAIMS BOARD

Title 2, Division 2, Rule 619.7(f) states that the Victim Compensation and Government Claims Board (VCGCB) shall maintain an index of significant and legal policy determinations contained in precedent decisions.

As authorized by Government Code section 11425.60, the VCGCB has designated several administrative decisions as precedent decisions. Members of the public may obtain the Index of Precedent Decisions by calling (916) 491-3863 or by sending a written request to the Victim Compensation and Government Claims Board, Attn: Geoff Feusahrens, 400 R Street, Suite 500, Sacramento, CA 95811. In addition, the Index of Precedent Decisions may also be found on the VCGCB website at <http://www.vcgcb.ca.gov>.





STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-80  
916-445-2130 • FAX 916-324-3984  
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BETTY T. YEE  
First District, San Francisco

BILL LEONARD  
Second District, Ontario/Sacramento

MICHELLE STEEL  
Third District, Rolling Hills Estates

JEROME E. HORTON  
Fourth District, Los Angeles

JOHN CHIANG  
State Controller

RAMON J. HIRSIG  
Executive Director

**January 20, 2010**

**To Interested Parties:**

**NOTICE OF CORRECTION  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

The State Board of Equalization issued an Interested Parties Letter on January 15, 2010 concerning California Code of Regulations, title 18, section (Regulation) 1698.5, Audit Procedures. The second paragraph of the letter contained a typographical error, which incorrectly indicated that the public hearing regarding the proposed regulatory action was scheduled for March 23, 2009, and that the deadline for the Board to receive written comments was prior to the start of the 2009 hearing. The NOPRA should have correctly provided that:

"A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation."

"Any interested person may also submit written comments regarding the adoption of the proposed regulation. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation."

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984 , by

Notice of Proposed Regulatory Action  
Regulation 1698.5

January 20, 2010

e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn:  
Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures



# Memorandum

To : Mr. Rick Bennion, Acting Regulations Coordinator  
Board Proceedings Division, MIC: 81

Date : February 5, 2010

From : Todd C. Gilman, Chief   
Taxpayers' Rights and Equal Employment Opportunity Division, MIC: 70

Subject : **Comments on Proposed Regulation 1698.5, Audit Procedures**

The Taxpayers' Rights Advocate Office wishes to recommend revisions to proposed Sales and Use Tax Regulation 1698.5, *Audit Procedures*, in connection with the public hearing on the proposed adoption of Regulation 1698.5, scheduled for March 23, 2010. The revisions described below and shown in ~~strikeout~~ and underline text are needed to ensure the adequate protection of taxpayers' rights. I have included commentary about some of the revisions in brackets and italics.

## (a) DEFINITIONS

(2) ENGAGEMENT LETTER. Correspondence used by the auditor to confirm the start of an audit or establish contact with the taxpayer.

*[New subdivision (a)(2) is to be placed prior to current subdivision (a)(2), and the remainder of the subdivisions in (a) are to be re-numbered.]*

(67) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, ~~which is used to confirm the start of an audit or establish contact with the taxpayer,~~ is not an IDR.

*[A separate definition for Audit Engagement Letter should be included in the list of terms, rather than included within the definition of another term.]*

## (b) GENERAL

### (b)(4) Duty of Board Staff.

(J) Safeguard taxpayers' records while examining them. Do not remove records from taxpayer's or taxpayer's representative's premises without permission from the taxpayer or designee. Provide signed receipt for any records removed from the premises.

*[It is important to be more specific on how Board staff effectively safeguards the taxpayer's records.]*

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit and be prepared to respond to questions about the audit process, taxpayers' rights, and appeal rights at any time during the course of the audit.

*[All Board staff are expected to be knowledgeable about taxpayers' rights and audit staff have the responsibility of safeguarding and respecting those rights.]*

**(b)(5) Duty of Taxpayers.**

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; ~~and provide adequate resources to do so.~~

*[It is presumptuous and exceeds BOE authority to promulgate requirements regarding allocation of the taxpayer's resources.]*

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

*[There also may be state laws or regulations that prohibit the copying of specific documents.]*

**(c) AUDITS.**

(1) Audit Engagement Letter. The audit engagement letter will enclose copies of, or provide references to the website locations of, Board publications explaining the audit process, taxpayers' rights, and appeal rights and procedures. The audit engagement letter will also provide contact information for the auditor and the auditor's supervisor.

*[New subdivision (c)(1) is to be placed prior to current subdivision (c)(1), and the remainder of the subdivisions in (c) re-numbered.*

*I understand the current procedure is to provide copies – or provide references to the location on the website – of the following BOE publications with the Audit Engagement Letter:*

- *Publication 17, Appeals Procedures*
- *Publication 70, Understanding Your Rights as a California Taxpayer*
- *Publication 76, Audits*

*Regulation 1698.5 should enunciate the auditor's duty to provide the taxpayer with written materials describing his or her rights.]*

Please let me know if you have any questions regarding these suggestions.

TCG:ls

Bennion memo 020510 (1698-5 comments).doc

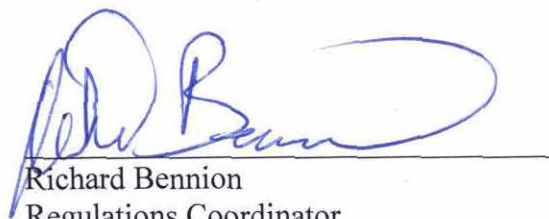
cc: Ms. Randie Henry, Deputy Director, Sales and Use Tax Department, MIC: 43



## Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Tax Regulation 1698.5, *Audit Procedures*, did comply with the provision of Government Code section 11346.4(a)(1) through (4). A notice to interested parties was mailed on January 20, 2010, 62 days prior to the public hearing.

April 27, 2010



Richard Bennion  
Regulations Coordinator  
State Board of Equalization

BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N STREET

SACRAMENTO, CALIFORNIA

REPORTER'S TRANSCRIPT

MARCH 23, 2010

ITEM F PUBLIC HEARING

ITEM F1 REGULATION 1698.5

AUDIT PROCEDURES

Reported by: Juli Price Jackson

No. CSR 5214



## P R E S E N T

For the Board  
of Equalization:

Betty T. Yee  
Chair

Jerome E. Horton  
Vice-Chair

Barbara Alby  
Acting Member

Michelle Steel  
Member

Marcy Jo Mandel  
Appearing for John  
Chiang, State Controller  
(per Government Code  
Section 7.9)

Diane G. Olson  
Chief, Board  
Proceedings Division

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450 N STREET  
SACRAMENTO, CALIFORNIA  
MARCH 23, 2010

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MS. OLSON: Our next item is F1, Regulation  
1698.5, Audit Procedures.

This is a public hearing.

MS. YEE: Good afternoon.

MR. TUCKER: Good afternoon, Members. My name  
is Robert Tucker of the Board's Legal staff. And with  
me is Jeff McGuire of the Sales and Use Tax Department.

Since the November 17th, 2009 Board meeting,  
the Sales and Use Tax Department and the Legal  
Department have identified one grammatical change and  
four sufficiently related changes to the original text  
of the proposed regulation.

The first two changes were made to subdivisions  
(a)6 and (a)7 to revise the definitions of "information  
document request" and "the audit findings presentation  
sheet" to delete the references to the word "form."

In addition, based on comments from the  
Taxpayer Rights Advocate, we deleted the phrase, "and  
provide adequate resources to do so," from subdivisions  
(e)5B and deleted "federal" from subdivision (b)5C.

We request the Board authorize staff to make  
the additional changes to the original text of the  
proposed regulation and refer the revised regulation to  
the 15-day file for additional notice and public



1 comment, as provided for by Government Code Section  
2 11346.8, subdivision C.

3 Thank you very much.

4 MS. YEE: Thank you, Mr. Tucker.

5 Questions, Members?

6 Ms. Mandel?

7 MS. MANDEL: Yes. I -- I had some questions  
8 and comments on the additional changes that Taxpayer  
9 Rights Advocate had asked for and that are not -- that  
10 staff is not recommending.

11 The first one had to do with separating out the  
12 definition of engagement letter, the definition of  
13 engagement letter currently is sort of incorporated into  
14 the definition of the information document request  
15 because the -- that definition of information document  
16 request says that an engagement letter, which is a blah,  
17 blah, blah -- I don't remember the exact words, but the  
18 definition of an engagement letter -- is not an I. D. R.

19 And all the Taxpayer Rights Advocate was asking  
20 was, "Why don't you leave the sentence that says an  
21 engagement letter is not an I. D. R., but why don't you  
22 put a separate, little definitional provision that says,  
23 'engagement letter is,' then what exactly the definition  
24 that you have embodied in the I. D. R.?"

25 And that one -- that one kind of looked like a  
26 no-brainer. I mean, to me -- I know your response was  
27 that it's the only place that an engagement letters is  
28 even referenced, but that, you know, we would hope

1       that -- I would hope that all staff always reads  
2       anything that you're sort of preparing with an eye  
3       towards how is it going to be read, you know, by someone  
4       else, by someone who has to apply it and, especially, by  
5       taxpayers who have to understand it and don't live and  
6       breathe BOE every day of their lives.

7               And it's particularly the role of Taxpayer  
8       Rights Advocate to read things with that eye. And, so,  
9       that one just seemed like a no-brainer to me to make  
10      and -- so, that was that first one.

11             MS. YEE: Could I add onto that question?

12             MS. MANDEL: Yeah.

13             MS. YEE: I guess I also would want to know  
14      after the regulation is approved by the Office of  
15      Administrative Law, what direction or instructions will  
16      be made available for the general public?

17             I'm not so sure that just referencing the  
18      regulation is going to provide enough guidance,  
19      necessarily, for just, you know, broader public  
20      understanding.

21             But I would hope that through the T. R. A.'s  
22      office that we're going to be having other publications  
23      that will make it clear what we're talking about here.

24             MR. MC GUIRE: Yeah, I think it -- you know,  
25      once the regulation's approved, we would make revisions  
26      to our current publications, like our Audit and Appeals  
27      publications so that this information is incorporated,  
28      as well as we will update our audit manual to



1 incorporate the provisions of the regulation and the  
2 audit manual is available on our website and is cited a  
3 lot of time by our taxpayers, you know, in the audit  
4 process.

5 MS. YEE: Yeah, I mean I agree with  
6 Ms. Mandel's goal, I just don't know the vehicle that  
7 would best serve the goal of, you know, just  
8 understanding what we're --

9 MS. MANDEL: Yeah, and it's --

10 MS. YEE: -- doing here.

11 MS. MANDEL: -- I think if it's in the -- for  
12 that -- that particular suggestion by Taxpayer Rights  
13 Advocate, I think I'd like to see that one added in  
14 because as life goes on and auditors say or someone says  
15 to a taxpayer, "Here, this is your audit engagement  
16 letter," you know, then -- it just seemed like -- that  
17 one just seemed like a real no-brainer and I wasn't sure  
18 why you were, you know, not acceding to it.

19 The other ones I think are -- some of them are  
20 interesting, but it seemed more like the one -- the next  
21 one had to do with adding to duty of Board staff when it  
22 talks about, "Safeguard taxpayer records while examining  
23 them," that the Taxpayer Rights Advocate wanted to add  
24 some specific prohibitions, which are, I think, probably  
25 included sort of elsewhere, maybe in the manual, audit  
26 manual, that they should not -- that they have to  
27 provide signed receipts for records that they remove and  
28 that they can't remove things without the taxpayer's rep

1 or taxpayer agreeing -- which we would hope never  
2 happens without that.

3 But that one didn't seem like it was more in  
4 the audit manual and I -- I mean I appreciate what  
5 Taxpayer Rights Advocate is suggesting, I was -- just I  
6 was concerned about whether putting something in that  
7 kind of thing, so specific in the reg, was in conflict  
8 with the more general nature what the reg was trying to  
9 do.

10 Was that your impression of --

11 MR. MC GUIRE: Yeah, that was our thought is  
12 that it -- we didn't want to get so specific that, you  
13 know, we -- we're kind of locked in in all cases.

14 MS. MANDEL: Yeah.

15 MR. MC GUIRE: And all specific circumstances.

16 MS. MANDEL: And I think that was the same  
17 thing with the specificity that the Taxpayer Rights  
18 Advocate -- and the only reason I'm going through them  
19 is because it is Taxpayer Rights Advocate. And I really  
20 want to pay attention to what they're suggesting because  
21 they do have that viewpoint of what exactly the audit --  
22 the engagement letter should include or should say.

23 And that also seemed that if it was so specific  
24 in the regulation, things might change, publication  
25 names and numbers might change. And what's appropriate  
26 might change and that also sounded like it was  
27 addressed in the audit manual.

28 MR. MC GUIRE: Right, as well as we thought in



1       that particular instance that the regulation itself also  
2       says that the auditors will inform the taxpayer of  
3       those things specifically.

4               So, we thought saying that you include them  
5       with a letter and then you also inform them, again, as  
6       things change, we thought it was good just to be more  
7       general, that we would inform of them their rights, the  
8       appeals process, the audit process versus listing  
9       specific things that we would include in the letter to  
10      them.

11             MS. MANDEL: Right. And as to sort of the last  
12      grouping, it seemed like our people should always be  
13      prepared to answer any kind of questions about the  
14      process at any point. And, certainly, taxpayers should  
15      know that they could ask at any point.

16             But there was one thing in that grouping that  
17      was -- it almost seemed like a typo or a word was  
18      missing and that had to do with the placement of the  
19      apostrophe. That particular provision talks about that  
20      the -- that the auditors should inform the taxpayer of  
21      the audit process, taxpayers' rights -- and it's  
22      apostrophe S -- and appeal rights at the beginning of  
23      the audit.

24             And when -- what Taxpayer Rights Advocate said  
25      was that the apostrophe on taxpayers' rights should be  
26      after the S because I think they're thinking you are  
27      talking about in general, taxpayer rights, like under  
28      the Taxpayer Bill of Rights. And that was kind of how I

1 read it the first time, but my eyes skimmed over the  
2 taxpayers' rights.

3 And if you're really talking appeal rights, you  
4 know, it seemed like -- well, how's taxpayers' rights  
5 different than appeal rights? And if you're talking  
6 about the Taxpayer Bill of Rights, then should you say  
7 Taxpayer Bill of Rights?

8 Or if you're talking about this individual  
9 taxpayer's rights, should you say, "the taxpayer's  
10 rights"?

11 And how -- so, I was -- that was interesting to  
12 me because it seemed like there was a little confusion  
13 about what is the subject matter that you're really  
14 covering in that what the auditor is supposed to inform  
15 the taxpayer of.

16 And your response didn't -- didn't seem to pick  
17 up on that aspect of it because you were focused on the  
18 request that they be prepared to respond at any moment  
19 in time on these things.

20 So, what do you think?

21 MR. MC GUIRE: I believe, in general, that  
22 while the bigger taxpayer rights we were trying to focus  
23 on the taxpayer under audit and their rights  
24 specifically, which are the broader rights that, you  
25 know, I guess no one taxpayer has different rights  
26 specifically than another, but there may be different  
27 circumstances related to their situation -- different  
28 ownership types and other things, a filing basis and



1 things that would give them different like requirements  
2 under the law.

3 And, so, I think we wanted to make it that it's  
4 customized to the taxpayer when you're explaining their  
5 rights. And staff should be well versed in the general  
6 taxpayer rights and be able to answer and respond to any  
7 questions.

8 MS. MANDEL: Todd, I think I see you back  
9 there, even without my glasses on.

10 Was that the confusion over that reference?  
11 Did you have that same --

12 MR. GILMAN: That was the general -- that was  
13 the general understanding, that was a confusion we had,  
14 so --

15 MS. MANDEL: Okay. So, do you -- do you think  
16 it's a problem still? Or are we talking about different  
17 things?

18 MR. GILMAN: Well, I think that Jeff's kind of  
19 hitting on what we were talking about.

20 I mean, we were looking at it from a more broad  
21 perspective as all taxpayers, where it sounds like what  
22 you're talking about, Jeff, is more customizing it  
23 towards --

24 MR. MC GUIRE: Well, I --

25 MR. GILMAN: -- a particular taxpayer that  
26 would be under audit.

27 Is that what you're saying?

28 MR. MC GUIRE: Uh-huh.

1 MR. GILMAN: And, so, we were looking at it  
2 more broadly in terms of all taxpayers, being treated --

3 MS. MANDEL: Do you think it's confusing? Is  
4 it something that should be clarified?

5 Is there --

6 MR. GILMAN: I think so.

7 MS. MANDEL: -- language that's --

8 MR. GILMAN: I mean, that's kind of the reason  
9 we put it out there, that was our thinking when we sat  
10 down, Lorraine and I sat down and started looking at  
11 this regulation.

12 So, --

13 MS. YEE: I guess the general expectation of  
14 informing taxpayers is there regardless. I mean, I'm  
15 not so sure I necessarily need to see it in the  
16 regulations.

17 But because we're really focused on the  
18 expectation of specific audits and kind of what's going  
19 to be required, I'm more partial to the less general.

20 MS. MANDEL: Well, Todd, if -- if the -- this  
21 is under duty of Board staff, this provision and it  
22 says, "Inform the taxpayer of the audit process,  
23 taxpayers' rights and appeal rights at the beginning of  
24 the audit."

25 Is life covered if the word "the" is stuck in  
26 before taxpayers'?

27 I'm just -- you know, I don't want there to be  
28 confusion.



1 MR. GILMAN: Right.

2 MS. MANDEL: And I understood -- you know, I  
3 was going with, oh, should it be they explained the  
4 Taxpayer Bill of Rights? But --

5 MR. GILMAN: Well --

6 MS. MANDEL: -- does it just help if you stick  
7 the word, "the taxpayers' rights"?

8 MR. GILMAN: I think it would, yeah, I think --

9 MS. MANDEL: And then don't have to change the  
10 apostrophe or worry about talking about the Taxpayer  
11 Bill of Rights in the reg itself?

12 MR. GILMAN: Right. Yeah, I mean -- I guess  
13 what we're trying to focus on is insuring that they  
14 understand the broader concept of what their rights  
15 were.

16 MS. MANDEL: The taxpayer understands?

17 MR. GILMAN: Yes. And if it just so happened  
18 that the taxpayer had personal questions in terms --  
19 which they would, in terms of how their rights affect  
20 them, then I would assume staff would go in deeper or  
21 provide more information to the taxpayer as to how their  
22 rights apply to them as an individual, as a business, as  
23 a taxpayer, basically.

24 MS. YEE: But we already provide information as  
25 it relates to their general rights, I think, as a matter  
26 of course, right?

27 I hope we do.

28 MR. GILMAN: Yes, that's correct.

1 MS. YEE: I hope we do.

2 And, so, I think that's why we're focused more  
3 on kind of the specific taxpayer in this instance.

4 MR. TUCKER: Right.

5 MR. MC GUIRE: Right. We were trying to focus  
6 a little bit more on their specific rights as it  
7 relates to their audit, not their --

8 MS. YEE: Right.

9 MR. MC GUIRE: -- Taxpayer Bill of Rights, a  
10 broader specific thing.

11 For instance, if they needed to file a claim  
12 for refund within a certain period of time, that might  
13 be specific based upon their reporting requirements,  
14 what period we were looking at.

15 And, so, explaining their rights so they  
16 understand as we start the audit if there's any  
17 obligations to them that are specifically related to  
18 them, they know what their rights are so that they can  
19 exercise those.

20 The Bill of Rights doesn't specifically talk  
21 about your rights as filing claims for refund, we have a  
22 refund section, but that, to us, is viewed as kind of  
23 their rights during the process of how they actually  
24 make decisions that protect them during the audit  
25 process.

26 MS. MANDEL: Okay, I would suggest that we  
27 insert the word is "the" before "taxpayers"

28 MR. MC GUIRE: That would be fine.



1 MS. MANDEL: That would be clarifying.

2 And then did you -- do you have a real -- I  
3 mean, he -- do you have a real issue with the separate  
4 definition or --

5 MR. MC GUIRE: No, I guess our --

6 MS. MANDEL: Did I explain, Todd?

7 Is that kind of what you were thinking of  
8 why -- you were like why isn't it just a separate  
9 definition?

10 Is there a reason not to have a separate  
11 definition on the engagement letter?

12 MR. MC GUIRE: We can -- I don't know -- I  
13 think it's six of one, half dozen of the other, really.

14 I think we just thought because -- initially we  
15 added those definitions because we were referring to  
16 forms.

17 Then O. A. L. thought, "Well, you really  
18 shouldn't refer to forms unless you have the form in the  
19 regulation." And, so, we were trying to take those out  
20 and the audit engagement letter is just a letter that we  
21 send to every taxpayer at the beginning of an audit kind  
22 of explaining the audit process.

23 That's when we include things like the  
24 publication 70, their Taxpayer Bill of Rights and the  
25 other information. And, so, we thought it was --  
26 initially when we looked at it, we thought it was  
27 adequately addressed under the other part of the  
28 regulation, but we can add a definition.

1 MS. MANDEL: Well, Todd, do you think it's a  
2 big deal?

3 MR. GILMAN: Yeah, I'd like -- you know, that's  
4 kind of why we put it out there.

5 MS. MANDEL: I'm just asking.

6 MS. YEE: All right.

7 Okay, looks like we'll be expanding on that  
8 then.

9 Ms. Alby and then Ms. Steel?

10 MS. ALBY: All right, thank you, Madam Chair.

11 This has been around, what, a year or so? This  
12 -- we've been kicking this around quite a bit.

13 MS. YEE: Been living it for a year.

14 MS. ALBY: I guess my question is, why can't  
15 you do what you're talking about now without this  
16 regulation?

17 Doesn't seem -- I don't know that we need this  
18 regulation. This has been my -- why I've scratched my  
19 head and Bill as well.

20 MS. YEE: I --

21 MS. ALBY: Why do we need this?

22 Staff can still do their job. They can file  
23 their audit plans, they can explain the taxpayers'  
24 rights to the taxpayer.

25 Why do we need this regulation?

26 MS. YEE: Can I take a shot at that -- since  
27 I've worked on this for the last year?

28 I think the biggest compelling reason for this



1 regulation is, given our limited resources, is to set up  
2 expectations to all parties of an audit about how to  
3 timely complete audits.

4 And the central focus here is really the  
5 furnishing of records, which has been, you know,  
6 frankly, a pretty problematic area in audits.

7 And, so, from my perspective, this really does  
8 lay out expectations for both the taxpayer and for our  
9 Board staff.

10 And we've tried to keep it general, not  
11 prescriptive. There will be other documents that will  
12 be provided to really be more instructive on a practical  
13 level, but that's really the focal point.

14 And can it be done without the regulation? I  
15 think, given the problems that we've seen come out of  
16 the districts, I would say some guidance here would be  
17 appropriate.

18 MS. ALBY: Well, I -- I appreciate that, Madam  
19 Chair.

20 I just am concerned about moving forward on  
21 this. I mean, O. A. L. has objected to the lack of a  
22 form specified in the reg, correct?

23 MR. TUCKER: That's just the terminology that  
24 was used and, so -- by changing that terminology, it now  
25 would pass their -- we expect it would pass -- meet  
26 their approval.

27 MS. YEE: Ms. Steel?

28 MS. STEEL: Actually, this language that it

1       came out much friendlier to taxpayers than last time you  
2       brought it out and tried to change it.

3               But I still believe that this regulation is  
4       totally unnecessary. We can still print the audit  
5       manual and is as-is because I know that we have deficit  
6       and we try to make more money in much faster, but  
7       doesn't mean that go faster means the taxpayer's going  
8       to pay much faster on this.

9               So, I think this is another just burdensome to  
10      the taxpayers, you know, if we make it regulation. We  
11      can just still keep up with it under, you know, when we  
12      print on the audit manual.

13              So, I still cannot really go for it as  
14      regulation for this one.

15              MS. YEE: Okay, thank you.

16              Other questions, Members?

17              Okay, looks like we have a proposed revision to  
18      expand upon the definition of audit engagement letter.

19              We have the insertion of the word "the" before  
20      "taxpayers'" relative to that provision.

21              Ms. Mandel had highlighted those changes.

22              Is there a motion?

23              MS. MANDEL: Yeah, I'll go ahead and move it  
24      with those changes.

25              MS. YEE: Okay. Motion by Ms. Mandel, second  
26      by Mr. Horton.

27              Please call the roll.

28              MS. OLSON: Madam Chair?



1 MS. YEE: Aye.  
2 MS. OLSON: Ms. Alby?  
3 MS. ALBY: No.  
4 MS. OLSON: Ms. Steel?  
5 MS. STEEL: No.  
6 MS. OLSON: Mr. Horton?  
7 MR. HORTON: Aye.  
8 MS. OLSON: Ms. Mandel?  
9 MS. MANDEL: Aye.  
10 MS. OLSON: Motion carries.  
11 MS. YEE: Thank you. Thank you very much.

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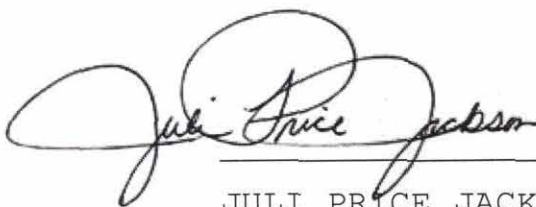
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## REPORTER'S CERTIFICATE

State of California       )  
                                      ) ss  
County of Sacramento     )

I, JULI PRICE JACKSON, Hearing Reporter for the California State Board of Equalization certify that on MARCH 23, 2010 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 18 constitute a complete and accurate transcription of the shorthand writing.

Dated: MAY 3, 2010



JULI PRICE JACKSON

Hearing Reporter





Tuesday, March 23, 2010

Appellant's Exhibit: Miscellaneous Documents ([Exhibit 3.2](#))

Action: Upon motion of Ms. Mandel, seconded by Mr. Horton and unanimously carried, Ms. Yee, Mr. Horton, Ms. Alby, Ms. Steel and Ms. Mandel voting yes, the Board submitted the appeal for decision.

## **PUBLIC HEARINGS**

### **Proposed Adoption of Regulation 1698.5, *Audit Procedures***

Robert Tucker, Tax Counsel, Tax and Fee Program Division, Legal Department, made introductory remarks regarding staff's recommendation to adopt additional changes to the original text of proposed Sales and Use Tax Regulation 1698.5, *Audit Procedures*, pursuant to Government Code section 11346.8. ([Exhibit 3.3.](#))

Speakers were invited to address the Board, but there were none.

Action: Upon motion of Ms. Mandel, seconded by Mr. Horton and duly carried, Ms. Yee, Mr. Horton and Ms. Mandel voting yes, Ms. Alby and Ms. Steel voting no, the Board approved further changes to the published version of Regulation 1698.5 and ordered that the changed version be placed in the rulemaking file for 15 days.

### **Proposed Amendments to Regulation 4903, *Innocent Spouse or Registered Domestic Partner Relief from Liability***

Carolee Johnstone, Tax Counsel, Tax and Fee Program Division, Legal Department, made introductory remarks regarding the proposed amendments to Regulation 4903, *Innocent Spouse or Registered Domestic Partner Relief from Liability*, and related cross-referencing regulations, to prescribe the requirements for obtaining innocent spouse relief from specified taxes and fees. ([Exhibit 3.4.](#))

Speakers were invited to address the Board, but there were none.

Action: Upon motion of Ms. Steel, seconded by Ms. Alby and unanimously carried, Ms. Yee, Mr. Horton, Ms. Alby, Ms. Steel and Ms. Mandel voting yes, the Board adopted the amendments to Regulation 4903 and related cross-referencing regulations as published.

## **LEGAL APPEALS MATTERS, CONSENT**

With respect to the Legal Appeals Matters Consent Agenda, upon a single motion of Ms. Alby, seconded by Mr. Horton and unanimously carried, Ms. Yee, Mr. Horton, Ms. Alby, Ms. Steel and Ms. Mandel voting yes, the Board made the following orders:

Liberty Supplies Company, Inc., 405242 (AA)


7-1-01 to 9-30-04, \$42,836.05 Tax

Action: Deny the petition for rehearing as recommended by the Appeals Division.

**Memorandum**

To: Honorable Betty T. Yee, Chairwoman  
Honorable Jerome E. Horton, Vice Chair  
Ms. Barbara Alby, Acting Board Member  
Honorable Michelle Steel  
Honorable John Chiang

Date: March 10, 2010

From: Kristine Cazadd  
Chief Counsel 

Subject: **Board Meeting – March 23-25, 2010**  
**Item F – Public Hearing**  
**Staff Recommendation for Additional Changes to the Original Text of Proposed Regulation 1698.5, *Audit Procedures*, Pursuant to Government Code section 11346.8.**

On November 17, 2009, the Board authorized staff to begin the formal rulemaking process to adopt Sales and Use Tax Regulation (Regulation) 1698.5, *Audit Procedures*, as set forth in exhibit 2 to Formal Issue Paper 09-005. Therefore, Board staff prepared and issued a Notice of Action, made the Initial Statement of Reasons and the original proposed text of the regulation available to the public, and scheduled a public hearing for the March 23, 2010, Board meeting.<sup>1</sup>

However, since the November 17, 2009, Board meeting, Sales and Use Tax Department staff and Legal Department staff have identified the need for one grammatical change and four sufficiently related changes to the original text of the proposed regulation, each of which is described in detail below and two of which were suggested by the Taxpayers' Rights Advocate (TRA). Therefore, at the public hearing scheduled during the March 23, 2010, Board meeting, the Legal Department will request that the Board authorize staff to make the additional changes to the original text of the proposed regulation and refer the revised regulation to the 15-day file for additional notice and public comment, as provided for by Government Code section 11346.8, subdivision (c).

**Changes to Regulation 1698.5, Subdivision (a)(6) and (7)**

Revenue and Taxation Code (RTC) section 7051 authorizes the Board to "prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of" the Sales and Use Tax Law (RTC § 6001 et seq.). The Board's rulemaking authority includes the authority to prescribe the content and use of forms by regulation so that the form requirements have the force and effect of law.

When the Board determines that it is necessary to prescribe the content of a form by regulation, the Board may include the full text of the form in the text of a regulation duly adopted or amended under chapter 3.5 (commencing with Gov. Code, § 11340) of the Administrative

<sup>1</sup> For ease of reference, Formal Issue Paper 09-005, and the Notice of Rulemaking, Initial Statement of Reasons, and original proposed text of Regulation 1698.5 are available on the Board's Website at:  
[http://www.boe.ca.gov/regs/reg1698\\_5.htm](http://www.boe.ca.gov/regs/reg1698_5.htm).



Procedure Act. For example, appendices A and B to Regulation 1668, *Sales for Resale*, include the full text of two Board adopted resale certificate forms. Alternatively, the Board may incorporate the full text of the form into the text of a duly adopted or amended regulation by reference under the procedures prescribed by the Office of Administrative Law (OAL) in Rule 20 (Cal. Code Regs., tit. 1, § 20). For example, Regulation 5603, subdivision (a), provides that a taxpayer's claim for reimbursement "must be filed with the Chief of Board Proceedings on the Taxpayers' Bill of Rights Reimbursement Claim form (7/98), which is hereby incorporated by reference."

In general, Rule 20, subdivision (c), allows the Board to incorporate a form into the text of a regulation by reference if the text of the proposed regulation or amendment states that the form is "incorporated by reference" and identifies the form by title and date of publication or issuance (as illustrated by Regulation 5603). And, the Board's notice of action for the proposed adoption of the regulation or amendment clearly identifies the form to be incorporated by reference by its title and date of publication or issuance; the Board makes the form available to the public during the notice and comment period specified in the notice of action; and the Board's final statement of reasons for the proposed adoption of the regulation or amendment demonstrates why it would be cumbersome, unduly expensive, or otherwise impractical to publish the form in the California Code of Regulations.

Formal Issue Paper 09-005 requested the Board's authorization to begin the formal rulemaking process to adopt proposed Regulation 1698.5, as forth in exhibit 2 to the issue paper. As relevant here:

- Pages 4 and 5 of the issue paper described the "Information/Document Request (IDR) process" and the "Audit Findings Presentation Sheet (AFPS) process" provided for in the text of proposed Regulation 1698.5;
- The text of proposed Regulation 1698.5, subdivision (a)(6) and (7), set forth in exhibit 2 to the issue paper, provided that an "Information/Document Request (IDR)" is a "Board form used to request single or multiple documents, data, and other information from the taxpayer under audit"; and an "Audit Findings Presentation Sheet (AFPS)" is a "Board form used to present the staff's findings for each area of the audit as it is completed," respectively;
- The text of proposed Regulation 1698.5, subdivision (c)(10)(B) and (11), set forth in exhibit 2 to the issue paper, prescribed the "Information/Document Request (IDR) process" and the "Audit Findings Presentation Sheet (AFPS) process," respectively;
- And, exhibits 3 and 4 to the issue paper contained draft templates for audit correspondence requesting information and documents and audit correspondence transmitting the Board's audit findings to taxpayers, which the headers referred to as a "Draft IDR Form" and "Draft AFPS Form," respectively.

Formal Issue Paper 09-005 did not request that the Board adopt or authorize staff to issue the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 because the templates were still under development.<sup>2</sup> Furthermore, the issue paper did not request or

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<sup>2</sup> The Sales and Use Tax Department plans to finish development and finalize the templates before it issues the operations memorandum implementing Regulation 1698.5.



recommend that the Board include the full text of the draft templates in the text of proposed Regulation 1698.5 or incorporate the draft templates into Regulation 1698.5 by reference in accordance with Rule 20. This is because the templates do not impose any regulatory requirements on taxpayers or Board staff that are not already provided for in the text of Regulation 1698.5, subdivision (c)(10)(B) and (11), and it is not necessary to prescribe the specific content of the draft templates by regulation. However, OAL staff performed a preliminary review of the original text of proposed Regulation 1698.5 and tentatively concluded that the Board is trying to incorporate the draft templates contained in exhibits 3 and 4 to the issue paper into Regulation 1698.5, subdivision (a)(6) and (7), by reference because the subdivision's text refers to IDRs and AFPSs as Board forms. Therefore, OAL staff contacted Board staff to express concerns that Board staff was not complying with the requirements of Rule 20 because the references to the forms did not include the dates the forms were adopted or issued and Board staff was not making the templates available to the public as part of the rulemaking documents for the proposed adoption of Regulation 1698.5.

The Board's Legal Department and Board Proceedings Division responded to OAL staff's concerns and explained that the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 have not been adopted or issued, the Board is not currently trying to incorporate the templates into Regulation 1698.5 by reference, and the Board does not need to comply with Rule 20. In addition, the Board's Legal Department discussed this matter with OAL's Legal Department and continues to believe that the templates the Sales and Use Tax Department will eventually implement for use in the IDR and AFPS processes will not need to be adopted as regulations because they will not impose any regulatory requirements on taxpayers or Board staff. However, to avoid any confusion and further clarify that the Board is not trying to incorporate IDR and AFPS forms into Regulation 1698.5 by reference in accordance with Rule 20, the Legal Department requests authorization to:

- Change the original text of proposed Regulation 1698.5, subdivision (a)(6), to provide that "Board staff may issue an Information Document/Request (IDR) to request single or multiple documents, data, and other information from the taxpayer under audit," as shown in Attachment A to this memorandum, rather than refer to an IDR as a Board form; and
- Change the original text of proposed Regulation 1698.5, subdivision (a)(7), to provide that "An Audit Findings Presentation Sheet (AFPS) is used to present the staff's findings for each area of the audit as it is completed," as shown in Attachment A, rather than refer to an AFPS as a Board form.

#### **Responses to TRA's Comments and Changes to Subdivision (b)(5)(B) and (C)**

On February 5, 2010, the TRA Office submitted written comments (see Attachment B) suggesting that the Board delete the phrase "and provide adequate resources to do so" and the word "federal" from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B) and (C), respectively. The Sales and Use Tax Department and the Legal Department agree that the phrase "and provide adequate resources to do so" should be deleted from subdivision (b)(5)(B), as shown in Attachment A, and jointly request the Board's authorization to make the change. In addition, the Sales and Use Tax Department and the Legal Department agree that subdivision (b)(5)(C) should be revised to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by law from requiring that taxpayers do so, as



shown in Attachment A, and jointly request the Board's authorization to change subdivision (b)(5)(C) accordingly.

The TRA Office also suggested that the Board:

- A. Delete language from the second sentence in subdivision (a)(6) of the original text of proposed Regulation 1698.5, regarding audit engagement letters;
- B. Add a new subdivision (a)(2) to define the term "Engagement Letter" for purposes of the entire regulation and renumber the other paragraphs in subdivision (a) accordingly; and
- C. Add a new subdivision (c)(1) and renumber the other paragraphs in subdivision (c) accordingly to require "Audit Engagement Letters" to "enclose copies of, or provide references to the website locations of, Board publications explaining the audit process, taxpayers' rights, and appeal rights and procedures," and provide contact information for the auditor and the auditor's supervisor.

The Sales and Use Tax Department does not agree that it is necessary to further define the term "Audit Engagement Letter" for purposes of the regulation, because the term is only used in the original text of proposed Regulation 1698.5, subdivision (a)(6), currently, and there is no forfeiture of rights if the taxpayer fails to respond to this letter. Furthermore, the Sales and Use Tax Department does not agree with the TRA that it is necessary to add a new subdivision (c)(1) because the original text of subdivisions (b)(4)(K) and (c)(6) already requires auditors to "Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit" and requires auditors to provide each taxpayer with the name and telephone number of their audit supervisor, and any Board staff assigned to the audit team, at the taxpayer's opening conference. Therefore, the Sales and Use Tax Department is not requesting the Board's authorization to delete language from the original text of subdivision (a)(6), or add new subdivisions (a)(2) or (c)(1) to the original text of proposed Regulation 1698.5.

Finally, the TRA Office also suggested that the Board:

1. Add language to the original text of proposed Regulation 1698.5, subdivision (b)(4)(J), prohibiting auditors from removing records from taxpayers' premises without permission and requiring auditors to provide signed receipts for any records they do remove from a taxpayer's premises; and
2. Revise the original text of proposed Regulation 1698.5, subdivision (b)(4)(K), to change taxpayer's to taxpayers', and require auditors to "be prepared to respond to questions about the audit process, taxpayers' rights, and appeal rights at any time during the course of [an] audit."

The Sales and Use Tax Department does not agree that the suggested changes to the original text of proposed Regulation 1698.5, subdivision (b)(4)(J) and (K), are necessary. This is because the original text of proposed Regulation 1698.5, subdivision (b)(4)(J), already requires auditors to "Safeguard taxpayers' records while examining them"; section 0403.35, *Receipt for Taxpayer's Records*, of the Board's Audit Manual<sup>3</sup> already requires auditors to safeguard

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<sup>3</sup> For ease of reference, chapter 4, *General Audit Procedures*, of the Audit Manual is available at <http://www.boe.ca.gov/pdf/fam-04.pdf>.



taxpayer information and provide receipts for records that are removed from taxpayers' premises; and the original proposed text of Regulation 1698.5, subdivision (b)(4)(K), already requires auditors to "Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit." Therefore, the Sales and Use Tax Department and the Legal Department are not requesting the Board's authorization to add language to subdivision (b)(4)(J) or revise subdivision (b)(4)(K) of the original text of proposed Regulation 1698.5.

### Solely Grammatical Changes

Finally, the Sales and Use Tax Department and Legal Department request the Board's authorization to delete the word "the" before the reference to "AFPSs" in the original text of proposed Regulation 1698.5, subdivision (a)(7), as shown in Attachment A, to make the revised sentence grammatically correct.

### Conclusion

The Sales and Use Tax Department and the Legal Department request that the Board authorize staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5, as shown in Attachment A, and refer the changes to the regulation to the 15-day file for additional public comment in accordance with Government Code section 11346.8, subdivision (c). Both departments believe that the recommended changes are necessary to clarify that the Board is not trying to incorporate regulatory forms into the proposed regulation, ensure that the proposed regulation does not require taxpayers to devote more resources to their audits than currently required, prohibit auditors from requiring taxpayers to produce documents when prohibited by law, not just federal law, and correct a minor grammatical error.

If you need more information or have any questions, please contact Tax Counsel III (Specialist) Bradley Heller at (916) 324-2657.

### STATE BOARD OF EQUALIZATION



BOARD APPROVED

At the March 23, 2010 Board Meeting

Diane G. Olson  
Diane G. Olson, Chief  
Board Proceedings Division

Approved:

Ramon J. Hirsig  
Ramon J. Hirsig  
Executive Director

Attachments: Suggested Changes to Proposed Text of California Code of Regulations, Title 18

Taxpayers' Rights Advocate Office Comments on Proposed Regulation 1698.5,  
Audit Procedures

KEC:bh:yg

J:/Bus/Use/Finals/Heller/Regulation 1698.doc

cc:	Mr. Ramon Hirsig	MIC: 73	Ms. Leila Hellmuth	MIC: 50
	Ms. Randie Henry	MIC: 43	Mr. Randy Ferris	MIC: 82
	Mr. Jeff McGuire	MIC: 92	Mr. Bradley Heller	MIC: 82



Suggested Changes to Proposed Text of  
California Code of Regulations, title 18

**Regulation 1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (6) INFORMATION/DOCUMENT REQUEST (IDR). ~~A~~Board staff may issue an Information Document/Request (IDR)~~Board form used~~ to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.
- (7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). An Audit Findings Presentation Sheet (AFPS) is ~~Board form~~ used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to ~~the~~ AFPSs.
- (8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (9) DAY. For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.



(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

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The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.



(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; ~~and provide adequate resources to do so.~~

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless the Board is ~~otherwise prohibited by federal law from requiring the specific documents.~~

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

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### **(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

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During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal

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The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.



contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

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The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.



As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.

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The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

# Memorandum

To : Mr. Rick Bennion, Acting Regulations Coordinator  
Board Proceedings Division, MIC: 81

Date : February 5, 2010

From : Todd C. Gilman, Chief *TCG*  
Taxpayers' Rights and Equal Employment Opportunity Division, MIC: 70

Subject : Comments on Proposed Regulation 1698.5, Audit Procedures

The Taxpayers' Rights Advocate Office wishes to recommend revisions to proposed Sales and Use Tax Regulation 1698.5, *Audit Procedures*, in connection with the public hearing on the proposed adoption of Regulation 1698.5, scheduled for March 23, 2010. The revisions described below and shown in strikeout and underline text are needed to ensure the adequate protection of taxpayers' rights. I have included commentary about some of the revisions in brackets and italics.

**(a) DEFINITIONS**

(2) ENGAGEMENT LETTER. Correspondence used by the auditor to confirm the start of an audit or establish contact with the taxpayer.

*[New subdivision (a)(2) is to be placed prior to current subdivision (a)(2), and the remainder of the subdivisions in (a) are to be re-numbered.]*

(67) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, ~~which is used to confirm the start of an audit or establish contact with the taxpayer,~~ is not an IDR.

*[A separate definition for Audit Engagement Letter should be included in the list of terms, rather than included within the definition of another term.]*

**(b) GENERAL**

**(b)(4) Duty of Board Staff.**

(J) Safeguard taxpayers' records while examining them. Do not remove records from taxpayer's or taxpayer's representative's premises without permission from the taxpayer or designee. Provide signed receipt for any records removed from the premises.

*[It is important to be more specific on how Board staff effectively safeguards the taxpayer's records.]*

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit and be prepared to respond to questions about the audit process, taxpayers' rights, and appeal rights at any time during the course of the audit.

*[All Board staff are expected to be knowledgeable about taxpayers' rights and audit staff have the responsibility of safeguarding and respecting those rights.]*



**(b)(5) Duty of Taxpayers.**

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; ~~and provide adequate resources to do so.~~

*[It is presumptuous and exceeds BOE authority to promulgate requirements regarding allocation of the taxpayer's resources.]*

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

*[There also may be state laws or regulations that prohibit the copying of specific documents.]*

**(c) AUDITS.**

(1) Audit Engagement Letter. The audit engagement letter will enclose copies of, or provide references to the website locations of, Board publications explaining the audit process, taxpayers' rights, and appeal rights and procedures. The audit engagement letter will also provide contact information for the auditor and the auditor's supervisor.

*[New subdivision (c)(1) is to be placed prior to current subdivision (c)(1), and the remainder of the subdivisions in (c) re-numbered.*

*I understand the current procedure is to provide copies – or provide references to the location on the website – of the following BOE publications with the Audit Engagement Letter:*

- *Publication 17, Appeals Procedures*
- *Publication 70, Understanding Your Rights as a California Taxpayer*
- *Publication 76, Audits*

*Regulation 1698.5 should enunciate the auditor's duty to provide the taxpayer with written materials describing his or her rights.]*

Please let me know if you have any questions regarding these suggestions.

TCG:ls

Bennion memo 020510 (1698-5 comments).doc

cc: Ms. Randie Henry, Deputy Director, Sales and Use Tax Department, MIC: 43



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

450 N STREET, SACRAMENTO, CALIFORNIA  
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JOHN CHIANG  
State Controller

RAMON J. HIRSIG  
Executive Director

**January 20, 2010**

**To Interested Parties:**

**NOTICE OF CORRECTION  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

The State Board of Equalization issued an Interested Parties Letter on January 15, 2010 concerning California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The second paragraph of the letter contained a typographical error, which incorrectly indicated that the public hearing regarding the proposed regulatory action was scheduled for March 23, 2009, and that the deadline for the Board to receive written comments was prior to the start of the 2009 hearing. The NOPRA should have correctly provided that:

"A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation."

"Any interested person may also submit written comments regarding the adoption of the proposed regulation. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation."

Any inquiries regarding this correction should be made to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by



Notice of Proposed Regulatory Action  
Regulation 1698.5

January 20, 2010

e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn:  
Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,

A handwritten signature in cursive script that reads "Diane G. Olson".

Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures



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**January 15, 2010**

**To Interested Parties:**

**Notice of Proposed Regulatory Action  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

**NOTICE IS HEREBY GIVEN**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, proposes to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 will be held in Room 121, 450 N Street, Sacramento, California, at 9:30 a.m., or as soon thereafter as the matter may be heard, on March 23, 2009. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation. In addition, if the Board receives written comments prior to the hearing on March 23, 2009, the statements, arguments, and/or contentions contained in those comments will be presented to and considered by the Board before the Board decides whether to adopt the proposed regulation.



## **INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW**

### **Current Law**

Section 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require, and section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities. The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits.

### **Proposed Regulation**

The Board proposes to adopt Regulation 1698.5 to prescribe the procedures for conducting sales and use tax audits. Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day."

Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request. Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit

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<sup>1</sup> The Board's Audit Manual is available at [www.boe.ca.gov/sutax/staxmanuals.htm](http://www.boe.ca.gov/sutax/staxmanuals.htm).



a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

The purpose of proposed Regulation 1698.5 is to prescribe the procedures for conducting sales and use tax audits. Proposed Regulation 1698.5 is necessary to prescribe the procedures Board staff must follow when performing sales and use tax audits and to provide guidance to taxpayers regarding those procedures and their duties to cooperate in the audit process.



There are no comparable federal regulations or statutes to proposed Regulation 1698.5.

**NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 does not impose a mandate on local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

**NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS**

The Board has determined that proposed Regulation 1698.5 will result in no direct or indirect cost or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

**NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Therefore, the Board has made an initial determination that proposed Regulation 1698.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The proposed regulation may affect small business.

**NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES**

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

**RESULTS OF THE ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The Board has determined that the adoption of proposed Regulation 1698.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

## **NO SIGNIFICANT EFFECT ON HOUSING COSTS**

Adoption of proposed Regulation 1698.5 will not have a significant effect on housing costs.

## **DETERMINATION REGARDING ALTERNATIVES**

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed, or be as effective as and less burdensome to affected private persons than the proposed action.

## **CONTACT PERSONS**

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Acting Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

## **AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION**

The Board has prepared an Initial Statement of Reasons and an underscored version of proposed Regulation 1698.5 showing its express terms. These documents and all information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed regulation and the Initial Statement of Reasons are also available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

## **SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8**

The Board may adopt proposed Regulation 1698.5 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the



January 15, 2010

originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed regulation, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting regulation will be mailed to those interested parties who commented on the proposed regulation orally or in writing or who asked to be informed of such changes. The text of the resulting regulation will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting regulation that are received prior to adoption.

#### **AVAILABILITY OF FINAL STATEMENT OF REASONS**

If the Board adopts proposed Regulation 1698.5, the Board will prepare a Final Statement of Reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at [www.boe.ca.gov](http://www.boe.ca.gov).

Sincerely,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures

## **Initial Statement of Reasons**

### **Proposed Adoption of California Code of Regulations, Title 18, Section 1698.5, *Audit Procedures***

#### **SPECIFIC PURPOSE AND NECESSITY**

Revenue and Taxation Code section (section) 7053 requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require. Section 7054 authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

The Board has established an audit program that is designed to verify the accuracy of sales and use tax returns and determine the correct amount of sales and use tax required to be paid, as quickly and efficiently as is practicable under the circumstances. The Board has also published an Audit Manual for use in the Board's audit program, which contains information about the procedures and techniques Board staff may utilize when performing audits.<sup>1</sup> The audit program ensures that the Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.) is uniformly adhered to and enforced throughout the state, and thereby promotes voluntary compliance and deters tax evasion.

However, the Board has not adopted regulations prescribing the procedures for conducting sales and use tax audits. Therefore, the Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation.

Regulation 1698.5, subdivision (a), defines the terms "Board," "Pre-Audit Conference," "Opening Conference," "Status Conferences," "Exit Conference," "Information/Document Request," "Audit Findings Presentation Sheet," "Records," and "Day." Regulation 1698.5, subdivision (b), explains that the Board has a duty to utilize its audit resources in an efficient and effective manner and that the purpose of an audit is to efficiently determine whether or not the correct amount of sales and use tax has been reported. Subdivision (b) requires Board staff to complete audits within the statutes of limitations for issuing Notices of Determination and Notices of Refund and provides procedures for Board staff to obtain written waivers of the statutes of limitations from taxpayers when necessary. Subdivision (b) prescribes Board staff's and taxpayers' duties during the audit process. For example, Board staff has a duty to apply the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax and to keep taxpayers informed about the status of their audits; and taxpayers have a duty to maintain adequate records and make them available to Board staff for inspection and copying upon request.

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<sup>1</sup> The Board's Audit Manual is available at [www.boe.ca.gov/sutax/staxmanuals.htm](http://www.boe.ca.gov/sutax/staxmanuals.htm).



Subdivision (b) also explains that the timeframes prescribed by the regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit, rather than prevent or limit a taxpayer's right to provide information, and the timeframes may be adjusted when warranted.

Regulation 1698.5, subdivision (c), prescribes the procedures for performing audits, requires Board staff to develop an audit plan that strives for the completion of each audit within a two-year timeframe, and suggests that taxpayers submit claims for refund at the beginning of their audits. Subdivision (c) prescribes the location of each audit, provides procedures for taxpayers to request a change of location, and permits Board staff to visit a taxpayer's places of business to gain a better understanding of the taxpayer's business operations even if an audit is not being conducted at the taxpayer's place of business. Subdivision (c) explains that field audit work is conducted during normal workdays and business hours throughout the year, however, Board staff will try to schedule field audit work so that it is performed at a time and in a manner that minimizes any adverse effects on taxpayers.

Regulation 1698.5, subdivision (c), also requires Board staff to verbally request records and provide taxpayers with a chance to comply with such requests before issuing written Information/Document Requests (IDRs) and resorting to the IDR process for demanding information; and explains that Board staff will communicate its audit findings to taxpayers using Audit Findings Presentation Sheets (AFPSs). In addition, subdivision (c) explains that taxpayers will be invited to:

- A *pre-audit conference* to discuss general audit procedures, the availability of and access to records, computer assisted audit procedures, relevant sampling issues, the data transfer process, the verification of data, the security of data, the timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs;
- An *opening conference* to discuss the scope of the audit, the audit plan, the audit processes and procedures, claims for refund, the estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments;
- A *status conference* or conferences to discuss the status of the audit, IDRs, and AFPSs, and to ensure that the audit is on track for completion within the estimated timeframes outlined in the audit plan; and
- An *exit conference* to discuss the audit findings, the audit schedules, the review process, how to prepay a liability, the taxpayer's agreement or disagreement with the audit findings, and the Board's appeal procedures.

Proposed regulation 1698.5 is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.

## **DOCUMENTS RELIED UPON**

The Board relied upon Formal Issue Paper 09-005 (November 2, 2009) and comments from interested parties and Board staff made during the Board's November 17, 2009, Business Taxes Committee meeting in deciding to propose the adoption of Regulation 1698.5. Issue Paper 09-005 is available on the Board's Website at [www.boe.ca.gov/meetings/pdf/Combined\\_1698.5.pdf](http://www.boe.ca.gov/meetings/pdf/Combined_1698.5.pdf). The audio and video from the November 17, 2009, Business Taxes Committee meeting is available on the Board's Website at [www.visualwebcaster.com/event.asp?id=53985](http://www.visualwebcaster.com/event.asp?id=53985). The minutes from the November 17, 2009, Business Taxes Committee meeting are available on the Board's Website at [www.boe.ca.gov/meetings/pdf/111709-Board\\_committee\\_minutes.pdf](http://www.boe.ca.gov/meetings/pdf/111709-Board_committee_minutes.pdf).

## **ALTERNATIVES CONSIDERED**

The Board considered whether it would be more appropriate to take no action as an alternative to adopting proposed Regulation 1698.5, during the Board's November 17, 2009, Business Taxes Committee meeting. The Board decided to propose the adoption of Regulation 1698.5 because the regulation is necessary to formalize the Board's audit procedures, ensure that Board staff applies the Sales and Use Tax Law fairly and consistently regardless of whether an audit results in a deficiency or refund of tax, and to document the audit process for taxpayers and Board staff.

## **NO ADVERSE ECONOMIC IMPACT ON BUSINESS**

Proposed Regulation 1698.5 is consistent with the Board's current practices and procedures for conducting sales and use tax audits. Furthermore, proposed Regulation 1698.5, subdivision (c)(4), expressly provides that "the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects." Therefore, the Board has determined that the proposed regulation will not have a significant adverse economic impact on business.



**Proposed Text of California Code of Regulations,  
Title 18, Section 1698.5**

**1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

(1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.

(2) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.

(3) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.

(4) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.

(5) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.

(6) INFORMATION/DOCUMENT REQUEST (IDR). A Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.

(7) AUDIT FINDINGS PRESENTATION SHEET (AFPS). A Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.

(8) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.

(9) DAY. For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.



(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.

(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless otherwise prohibited by federal law.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

### **(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.



(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.



(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.



As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.

## Regulation History

**Type of Regulation:** Sales and Use Tax

Regulation: 1698.5

Title: 1698.5, *Audit Procedures*

**Preparation:** Brad Heller

**Legal Contact:** Brad Heller

Board proposes to adopt Regulation 1698.5, *Audit Procedures*, for the specific purpose of incorporating the Board's general audit procedures into a regulation.

### History of Proposed Regulation:

March 23, 2010	Public hearing
March 1, 2010	45-day public comment period ends
January 15, 2010	OAL publication date; 45-day public comment period begins; IP mailing
January 5, 2010	Notice to OAL
November 17, 2009	Business Tax Committee, Board Authorized Publication (vote 5 -0)

Sponsor: NA

Support: NA

Oppose: NA



**ESTIMATE OF COST OR SAVINGS RESULTING  
FROM PROPOSED REGULATORY ACTION**

**Proposed Amendment of Sales and Use Tax Regulation 1698.5, *Audit Procedures***


**STATEMENT OF COST OR SAVINGS FOR NOTICE OF PUBLIC HEARING**

The State Board of Equalization has determined that the proposed action does not impose a mandate on local agencies or school districts. Further, the Board has determined that the action will result in no direct or indirect cost or savings to any State agency, any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code or other non-discretionary cost or savings imposed on local agencies, or cost or savings in Federal funding to the State of California.

The cost impact on private persons or businesses will be insignificant. This proposal will not have a significant adverse economic impact on businesses.

This proposal will not be detrimental to California businesses in competing with businesses in other states.

This proposal will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses or create or expand business in the State of California.

Statement  
Prepared by  Date 1-6-2010  
Regulations Coordinator

Approved by  Date 1/14/10  
Chief Counsel

**If Costs or Savings are Identified, Signatures of Chief, Fiscal Management Division, and Chief, Board Proceedings Division, are Required**

Approved by \_\_\_\_\_ Date \_\_\_\_\_  
Chief, Financial Management Division

Approved by \_\_\_\_\_ Date \_\_\_\_\_  
Chief, Board Proceedings Division

**NOTE:** SAM Section 6660 requires that estimates resulting in cost or savings be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.

Board Proceedings Division  
10/7/05

**ECONOMIC AND FISCAL IMPACT STATEMENT****(REGULATIONS AND ORDERS)**

STD. 399 (REV. 12/2008)

**See SAM Section 6601 - 6616 for Instructions and Code Citations**

DEPARTMENT NAME State Board of Equalization	CONTACT PERSON Rick Bennion	TELEPHONE NUMBER 916-445-2130
DESCRIPTIVE TITLE FROM NOTICE REGISTER OR FORM 400 Title 18, Section 1698.5, Audit Procedures		NOTICE FILE NUMBER Z

**ECONOMIC IMPACT STATEMENT****A. ESTIMATED PRIVATE SECTOR COST IMPACTS (Include calculations and assumptions in the rulemaking record.)**

1. Check the appropriate box(es) below to indicate whether this regulation:

☐ a. Impacts businesses and/or employees☐ b. Impacts small businesses☐ c. Impacts jobs or occupations☐ d. Impacts California competitiveness☐ e. Imposes reporting requirements☐ f. Imposes prescriptive instead of performance☐ g. Impacts individuals☒ h. None of the above (Explain below. Complete the Fiscal Impact Statement as appropriate.)

h. (cont.) No significant adverse economic impact on business or employees, small business, jobs or occupations.

(If any box in Items 1 a through g is checked, complete this Economic Impact Statement.)

2. Enter the total number of businesses impacted: \_\_\_\_\_ Describe the types of businesses (Include nonprofits.): \_\_\_\_\_

Enter the number or percentage of total businesses impacted that are small businesses: \_\_\_\_\_

Enter the number of businesses that will be created: \_\_\_\_\_ eliminated: \_\_\_\_\_

Explain: \_\_\_\_\_

4. Indicate the geographic extent of impacts: ☐ Statewide ☐ Local or regional (List areas.): \_\_\_\_\_

5. Enter the number of jobs created: \_\_\_\_\_ or eliminated: \_\_\_\_\_ Describe the types of jobs or occupations impacted: \_\_\_\_\_

6. Will the regulation affect the ability of California businesses to compete with other states by making it more costly to produce goods or services here?

☐ Yes ☐ No If yes, explain briefly: \_\_\_\_\_**B. ESTIMATED COSTS (Include calculations and assumptions in the rulemaking record.)**

1. What are the total statewide dollar costs that businesses and individuals may incur to comply with this regulation over its lifetime? \$ \_\_\_\_\_

a. Initial costs for a small business: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

b. Initial costs for a typical business: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

c. Initial costs for an individual: \$ \_\_\_\_\_ Annual ongoing costs: \$ \_\_\_\_\_ Years: \_\_\_\_\_

Describe other economic costs that may occur: \_\_\_\_\_



**ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)**

2. If multiple industries are impacted, enter the share of total costs for each industry: \_\_\_\_\_

3. If the regulation imposes reporting requirements, enter the annual costs a typical business may incur to comply with these requirements. (Include the dollar costs to do programming, record keeping, reporting, and other paperwork, whether or not the paperwork must be submitted.): \$ \_\_\_\_\_

4. Will this regulation directly impact housing costs? ☐ Yes ☐ No If yes, enter the annual dollar cost per housing unit: \_\_\_\_\_ and the number of units: \_\_\_\_\_

5. Are there comparable Federal regulations? ☐ Yes ☐ No Explain the need for State regulation given the existence or absence of Federal regulations: \_\_\_\_\_

Enter any additional costs to businesses and/or individuals that may be due to State - Federal differences: \$ \_\_\_\_\_

**C. ESTIMATED BENEFITS** (Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. Briefly summarize the benefits that may result from this regulation and who will benefit: \_\_\_\_\_

2. Are the benefits the result of: ☐ specific statutory requirements, or ☐ goals developed by the agency based on broad statutory authority?

Explain: \_\_\_\_\_

3. What are the total statewide benefits from this regulation over its lifetime? \$ \_\_\_\_\_

**D. ALTERNATIVES TO THE REGULATION** (Include calculations and assumptions in the rulemaking record. Estimation of the dollar value of benefits is not specifically required by rulemaking law, but encouraged.)

1. List alternatives considered and describe them below. If no alternatives were considered, explain why not: \_\_\_\_\_

2. Summarize the total statewide costs and benefits from this regulation and each alternative considered:

Regulation:	Benefit: \$ _____	Cost: \$ _____
Alternative 1:	Benefit: \$ _____	Cost: \$ _____
Alternative 2:	Benefit: \$ _____	Cost: \$ _____

3. Briefly discuss any quantification issues that are relevant to a comparison of estimated costs and benefits for this regulation or alternatives: \_\_\_\_\_

4. Rulemaking law requires agencies to consider performance standards as an alternative, if a regulation mandates the use of specific technologies or equipment, or prescribes specific actions or procedures. Were performance standards considered to lower compliance costs? ☐ Yes ☐ No

Explain: \_\_\_\_\_

**E. MAJOR REGULATIONS** (Include calculations and assumptions in the rulemaking record.) Cal/EPA boards, offices, and departments are subject to the following additional requirements per Health and Safety Code section 57005.

**ECONOMIC AND FISCAL IMPACT STATEMENT cont. (STD. 399, Rev. 12/2008)**

1. Will the estimated costs of this regulation to California business enterprises exceed \$10 million ?    ☐ Yes    ☐ No (If No, skip the rest of this section.)

Briefly describe each equally as an effective alternative, or combination of alternatives, for which a cost-effectiveness analysis was performed:

Alternative 1: \_\_\_\_\_

Alternative 2: \_\_\_\_\_

3. For the regulation, and each alternative just described, enter the estimated total cost and overall cost-effectiveness ratio:

Regulation:                    \$ \_\_\_\_\_                    Cost-effectiveness ratio: \$ \_\_\_\_\_

Alternative 1:                \$ \_\_\_\_\_                    Cost-effectiveness ratio: \$ \_\_\_\_\_

Alternative 2:                \$ \_\_\_\_\_                    Cost-effectiveness ratio: \$ \_\_\_\_\_

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**FISCAL IMPACT STATEMENT**

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**A. FISCAL EFFECT ON LOCAL GOVERNMENT** (Indicate appropriate boxes 1 through 6 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)

☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year which are reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code. Funding for this reimbursement:

☐ a. is provided in \_\_\_\_\_, Budget Act of \_\_\_\_\_ or Chapter \_\_\_\_\_, Statutes of \_\_\_\_\_

☐ b. will be requested in the \_\_\_\_\_ Governor's Budget for appropriation in Budget Act of \_\_\_\_\_  
(FISCAL YEAR)

☐ 2. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year which are not reimbursable by the State pursuant to Section 6 of Article XIII B of the California Constitution and Sections 17500 et seq. of the Government Code because this regulation:

☐ a. implements the Federal mandate contained in \_\_\_\_\_

☐ b. implements the court mandate set forth by the \_\_\_\_\_  
court in the case of \_\_\_\_\_ vs. \_\_\_\_\_

☐ c. implements a mandate of the people of this State expressed in their approval of Proposition No. \_\_\_\_\_ at the \_\_\_\_\_  
election; (DATE)

☐ d. is issued only in response to a specific request from the \_\_\_\_\_  
\_\_\_\_\_, which is/are the only local entity(s) affected;

☐ e. will be fully financed from the \_\_\_\_\_ authorized by Section \_\_\_\_\_  
(FEES, REVENUE, ETC.)  
\_\_\_\_\_ of the \_\_\_\_\_ Code;

☐ f. provides for savings to each affected unit of local government which will, at a minimum, offset any additional costs to each such unit;

☐ g. creates, eliminates, or changes the penalty for a new crime or infraction contained in \_\_\_\_\_

☐ 3. Savings of approximately \$ \_\_\_\_\_ annually.

☐ 4. No additional costs or savings because this regulation makes only technical, non-substantive or clarifying changes to current law regulations.



**ECONOMIC AND FISCAL IMPACT STATEMENT *cont.* (STD. 399, Rev. 2-98)**

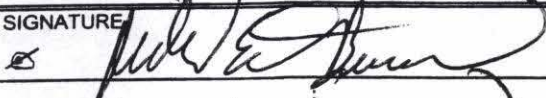

- ☒ 5. No fiscal impact exists because this regulation does not affect any local entity or program.
- ☐ 6. Other.

**B. FISCAL EFFECT ON STATE GOVERNMENT** *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

- ☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year. It is anticipated that State agencies will:
- ☐ a. be able to absorb these additional costs within their existing budgets and resources.
- ☐ b. request an increase in the currently authorized budget level for the \_\_\_\_\_ fiscal year.
- ☐ 2. Savings of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☒ 3. No fiscal impact exists because this regulation does not affect any State agency or program.
- ☐ 4. Other.

**C. FISCAL EFFECT ON FEDERAL FUNDING OF STATE PROGRAMS** *(Indicate appropriate boxes 1 through 4 and attach calculations and assumptions of fiscal impact for the current year and two subsequent Fiscal Years.)*

- ☐ 1. Additional expenditures of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☐ 2. Savings of approximately \$ \_\_\_\_\_ in the current State Fiscal Year.
- ☒ 3. No fiscal impact exists because this regulation does not affect any federally funded State agency or program.
- ☐ 4. Other.

SIGNATURE 		TITLE Regulations Coordinator
AGENCY SECRETARY <sup>1</sup>	PROGRAM BUDGET MANAGER 	DATE 1/5/10
APPROVAL/CONCURRENCE		DATE
DEPARTMENT OF FINANCE <sup>2</sup>	Exempt under SAM section 6660	
APPROVAL/CONCURRENCE		

- The signature attests that the agency has completed the STD. 399 according to the instructions in SAM sections 6600-6680, and understands the impacts of the proposed rulemaking. State boards, offices, or departments not under an Agency Secretary must have the form signed by the highest ranking official in the organization.
- Finance approval and signature is required when SAM sections 6600-6670 require completion of the Fiscal Impact Statement in the STD. 399.



STATE OF CALIFORNIA

**STATE BOARD OF EQUALIZATION**

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Acting Member  
Second District, Sacramento

RAMON J. HIRSIG  
Executive Director

**April 9, 2010**

**To Interested Parties:**

**Notice of Proposed Regulatory Action  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

**Approved Changes For 15-Day File**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, has proposed to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 was held in Room 121, 450 N Street, Sacramento, California, on March 23, 2010. No interested parties asked to speak at the public hearing or submitted written comments on the proposed amendments. However, the Board did authorize staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5, and referred Regulation 1698.5, to the fifteen-day file as described below.



## **Sufficiently Related Changes to the Original Proposed Text to Address the Office of Administrative Law's Concerns Regarding Information/Document Requests and Audit Findings Presentation Sheets**

Office of Administrative Law (OAL) staff performed a preliminary review of the original text of proposed Regulation 1698.5 and tentatively concluded that the Board is trying to incorporate the draft Information/Document Request (IDR) and Audit Findings Presentation Sheet (AFPS) templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005<sup>1</sup> into Regulation 1698.5, subdivision (a)(6) and (7), by reference under California Code of Regulations, title 1, section 20 (Rule 20) because the templates and the subdivision's text refers to IDRs and AFPSs as Board forms. Therefore, OAL staff contacted Board staff to express concerns that Board staff was not complying with the requirements of Rule 20 because the references to the forms did not include the dates the forms were adopted or issued and Board staff was not making the templates available to the public as part of the rulemaking documents for the proposed adoption of Regulation 1698.5.

Board staff responded to OAL staff's concerns and explained that the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 have not been adopted or issued, the Board is not currently trying to incorporate the templates into Regulation 1698.5 by reference, and the Board does not need to comply with Rule 20. In addition, the Board's Legal Department discussed this matter with OAL's Legal Department and continues to believe that the templates the Sales and Use Tax Department will eventually implement for use in the IDR and AFPS processes will not need to be adopted as regulations because they will not impose any regulatory requirements on taxpayers or Board staff. However, to avoid any confusion and further clarify that the Board is not trying to incorporate IDR and AFPS forms into Regulation 1698.5 by reference in accordance with Rule 20, the Board's Legal Department requested authorization to:

- Change the original text of proposed Regulation 1698.5, subdivision (a)(6), to provide that "Board staff may issue an Information Document/Request (IDR) to request single or multiple documents, data, and other information from the taxpayer under audit," rather than refer to an IDR as a Board form; and
- Change the original text of proposed Regulation 1698.5, subdivision (a)(7), to provide that "An Audit Findings Presentation Sheet (AFPS) is used to present the staff's findings for each area of the audit as it is completed," rather than refer to an AFPS as a Board form.

Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to

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<sup>1</sup> For ease of reference, Formal Issue Paper 09-005, and the Notice of Rulemaking, Initial Statement of Reasons, and original proposed text of Regulation 1698.5 are available on the Board's Website at: [http://www.boe.ca.gov/regs/reg1698\\_5.htm](http://www.boe.ca.gov/regs/reg1698_5.htm).



make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

### **Sufficiently Related Changes to the Original Proposed Text to Address the Board's Taxpayers' Rights Advocate Office's Concerns**

On February 5, 2010, the Board's own Taxpayers' Rights Advocate (TRA) Office submitted written comments to the Board's regulations coordinator suggesting that the Board delete the phrase "and provide adequate resources to do so" and the word "federal" from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B) and (C), respectively.<sup>2</sup> The Board's Sales and Use Tax Department and the Legal Department agreed with the TRA Office's comment that the phrase "and provide adequate resources to do so" should be deleted from subdivision (b)(5)(B) because the Board cannot require taxpayers to devote adequate resources to their audits and jointly requested the Board's authorization to make the sufficiently related change. In addition, the Sales and Use Tax Department and the Legal Department agreed that subdivision (b)(5)(C) should be revised to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by any applicable law, not just a "federal" law, from requiring that taxpayers do so and jointly requested the Board's authorization to change subdivision (b)(5)(C). Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

In addition, the TRA Office suggested that the Board delete the phrase "which is used to confirm the start of an audit or establish contact with the taxpayer" from subdivision (a)(6) of the original text of proposed Regulation 1698.5; and add a new subdivision (a)(2) to the original text of proposed Regulation 1698.5 to define the term "audit engagement letter" for purposes of the entire regulation and renumber the other paragraphs in subdivision (a) accordingly. During the public hearing on March 23, 2010, the Board agreed with the TRA Office that the changes were necessary to ensure that taxpayers did not confuse "audit engagement letters," IDRs, and AFPSs. Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days

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<sup>2</sup> For ease of reference, the TRA Office's comments are attached to and responded to in the March 10, 2010, memorandum from the Board's Chief Counsel to the Board Members for consideration at the March 23, 2010, public hearing, which is available at [http://www.boe.ca.gov/meetings/pdf/F1\\_032310.pdf](http://www.boe.ca.gov/meetings/pdf/F1_032310.pdf).



before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

### **Grammatical Changes to the Original Proposed Text**

Furthermore, the Sales and Use Tax Department and Legal Department requested the Board's authorization to delete the word "the" before the reference to "AFPSs" in the original text of proposed Regulation 1698.5, subdivision (a)(7), to make the revised sentence grammatically correct; and the Board Members noticed that the word "the" was need before the word "taxpayer's" in the original text of proposed Regulation 1698.5, subdivision (b)(4)(K), to make the revised sentence grammatically correct. Therefore, the Board authorized Board staff to make both grammatical changes to the original text of proposed regulation 1698.5 in accordance with Government Code section 11346.8, subdivision (c)(1)

### **Necessity**

Finally, the Board discussed the necessity for proposed Regulation 1698.5 during the March 23, 2010, public hearing. The Board Chair indicated that the regulation is necessary to clearly establish taxpayers' and Board staff's responsibilities and duties during the audit process in order to ensure that Board staff completes audits in a timely and efficient manner with due regard to each taxpayer's rights, and to help taxpayers better understand and avoid confusion regarding the Board's audit process.

### **Additional Comments Regarding Changes**

Enclosed is a revised underscore and strikeout version of the text of proposed Regulation 1698.5 with the additional changes authorized on March 23, 2010, shown in double strikeout and double underline. In accordance with Government Code section 11346.8, subdivision (c), the revised version of the regulation is being placed in the rulemaking file and mailed to interested parties who commented orally or in writing, or who asked to be informed of such revisions. If you wish to review the rulemaking file, it is available for your inspection at the State Board of Equalization, 450 N Street, Sacramento, CA 95814.

The revised version of the text of proposed Regulation 1698.5 will be placed on the May 25, 2010, Board meeting agenda for the Board's consideration and potential adoption at 9:30 a.m., or as soon thereafter as the matter may be heard. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation.

In addition, any interested person may also submit written comments regarding the Board's proposed adoption of the revised text of Regulation 1698.5. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter

may be heard, on May 25, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation. Furthermore, any written comments received prior to the end of the written comment period must be responded to in the final statement of reasons required by Government Code section 11346.9.

Questions regarding the substance of the revised version of the proposed regulation should be directed to Bradley M. Heller, Tax, Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the May 25, 2010, Board meeting, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81 I 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures



**Revised Text of  
California Code of Regulations,  
Title 18,**

**Regulation 1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

(1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.

(2) AUDIT ENGAGEMENT LETTER. An audit engagement letter is correspondence used by Board staff to confirm the start of an audit or establish contact with the taxpayer.

(3) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.

(4) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.

(5) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.

(6) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.

(7) INFORMATION/DOCUMENT REQUEST (IDR). A Board staff may issue an Information/Document Request (IDR) Board form used to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, which is used to confirm the start of an audit or establish contact with the taxpayer, is not an IDR.

(8) AUDIT FINDINGS PRESENTATION SHEET (AFPS). An Audit Findings Presentation Sheet (AFPS) is Board form used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.

(9) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.

(10) DAY. For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for



appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.



(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, the taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; ~~and provide adequate resources to do so.~~

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless the Board is otherwise prohibited by federal law from requiring the specific documents.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

### **(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These



subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's



records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit



findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.



**Olson, Diane****From:** BOE-Board Meeting Material**Sent:** Friday, April 09, 2010 10:55 AM

**To:** Alonzo, Mary Ann; Anderson, Doug; Anderson, Karen E.; Baland, Tabitha; Barnett, Louis; Bartolo, Lynn; Bennion, Richard; Blake, Sue; BOE-Board Meeting Material; Boring, Dilara; Cazadd, Kristine; Chinn, Elan; Chung, Sophia; Davis, Toya P.; Delgado, Maria; Epolite, Anthony; Evans, Regina; Ferris, Randy; Forman, Amber M; Garcia, Laura; Gau, David; Gilman, Todd; Giorgi, Dolores; Goehring, Teresa; Gore, Anita; Hale, Mike; Harvill, Mai; He, Mengjun; Heller, Bradley; Hellmuth, Leila; Henry, Randie; Hirsig, Ramon; Hudson, Tom; Ingenito, Robert; Jacobson, Andrew; Kinkle, Sherrie; Lambert, Robert; Langston, Bruce; Levine, David H. - Legal; LoFaso, Alan; Maddox, Ken; Maeng, Elizabeth; Mannering, Shari; Mandel, Marcy Jo; Matsumoto, Sid; Mandel, Marcy Jo @ SCO; Moon, Richard; Morquecho, Raymond; Ogrod, Jean; Olson, Diane; Pennington, Margaret; Qualset, Gary; Ralston, NaTasha; Riley, Denise; Ruwart, Carole; Shah, Neil; Smith, Rose; Stowers, Yvette; Tran, Mai; Treichelt, Tim; Whitaker, Lynn; Williams, Lee

**Subject:** State Board of Equalization - Announcement of Regulatory Change

The State Board of Equalization held a public hearing on the proposed adoption of Regulation 1698.5 on March 23, 2010. No interested parties asked to speak at the public hearing or submitted written comments on the proposed regulation. However, the Board did authorize staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5 described in the 15-day file letter below. The revised text of proposed Regulation 1698.5 will be placed on the Board's agenda for consideration and potential adoption in Room 121, 450 N Street, Sacramento, at 9:30 a.m., or as soon thereafter as the matter may be heard, on Tuesday, May 25, 2010.

To view the 15-day file letter and revised text showing the changes click on the following link:  
[http://www.boe.ca.gov/meetings/pdf/Regulation\\_1698\\_5\\_15\\_day.pdf](http://www.boe.ca.gov/meetings/pdf/Regulation_1698_5_15_day.pdf)

Questions regarding the substance of the changes to proposed Regulation 1698.5 should be directed to: Mr. Bradley Heller, Tax Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notices of intent to present testimony or witnesses at the Board meeting, and inquiries concerning the proposed regulatory action should be directed to Rick Bennion, Regulations Coordinator, telephone (916) 445-2130, fax (916) 324-3984, e-mail [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov) or by mail to: State Board of Equalization, Attn: Rick Bennion, MIC: 80, P.O. Box 942879, Sacramento, CA 94279-0080.

Please do not reply to this message. For additional information on this item, please contact:

Board Proceedings Division, MIC:80  
 Rick Bennion  
 Regulations Coordinator  
 Phone (916) 445-2130  
 Fax (916) 324-3984  
[Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov)

## Statement of Compliance

The State Board of Equalization, in process of adopting Sales and Use Tax Regulation 1698.5, *Audit Procedures*, did comply with the provision of Government Code section 1346.8(c) and section 44 of Title 1, California Code of Regulations. The 15-day letter and the changed version of Regulation 1698.5 were mailed on April 9, 2010, to interested parties who commented orally or in writing or that requested such information and were made available for public comment from April 9 to May 25, 2010, a period of 46 days prior to the public hearing.

April 21, 2010



Richard E. Bennion  
Regulations Coordinator  
State Board of Equalization



## 2010 MINUTES OF THE STATE BOARD OF EQUALIZATION

Wednesday, May 26, 2010

8112	Mosaic Networkx, LLC	3,740
8113	Calcatchers, Inc.	917,400
8114	Sunycell, Inc.	5,830
8115	&TV Communications, Inc.	1,716,000
8116	PC Landing Inc.	12,300,000
8117	Syniverse ICX Corporation	3,730,000
8118	IntelePeer, Inc.	2,700,000
8119	Express Telecommunications Network, LLC	4,840
8120	TELUS Communications Inc.	1,950,000

Action: Upon motion of Ms. Steel, seconded by Ms. Alby and unanimously carried, Ms. Yee, Mr. Horton, Ms. Alby, Ms. Steel and Mr. Chiang voting yes, the Board ordered that the market value, including penalty, to be used in the assessment of unitary property of the following listed company as of January 1, 2010, be as follows:

7581	ABS-CBN Telecom North America, Inc.	287,700
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The Board recessed at 1:53 p.m. and reconvened at 1:56 p.m. with Ms. Yee, Mr. Horton, Ms. Alby, Ms. Steel and Ms. Mandel present.

**CHIEF COUNSEL MATTERS****[J] RULEMAKING****J1 Proposed Regulation 1698.5, *Audit Procedures***

Bradley Heller, Tax Counsel, Tax and Fee Program Division, Legal Department, made introductory remarks regarding the request for Board adoption of the proposed regulation 1698.5, *Audit Procedures*, with the amendments approved at the public hearing on March 23, 2010. (Exhibit 5.2.)

Action: Upon motion of Mr. Horton, seconded by Ms. Mandel and duly carried, Ms. Yee, Mr. Horton and Ms. Mandel voting yes, Ms. Alby and Ms. Steel voting no, the Board adopted the proposed regulation 1698.5, *Audit Procedures*, as amended at the March 23, 2010 public hearing.

Exhibits are incorporated by reference.



**STATE BOARD OF EQUALIZATION**

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BETTY T. YEE  
First District, San Francisco

MICHELLE STEEL  
Third District, Rolling Hills Estates

JEROME E. HORTON  
Fourth District, Los Angeles

JOHN CHIANG  
State Controller

BARBARA ALBY  
Acting Member  
Second District, Sacramento

RAMON J. HIRSIG  
Executive Director

**April 9, 2010**

**To Interested Parties:**

**Notice of Proposed Regulatory Action  
By the  
The State Board of Equalization**

**Proposes to Adopt California Code of Regulations,  
Title 18, Section 1698.5, *Audit Procedures***

**Approved Changes For 15-Day File**

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code section 7051, has proposed to adopt California Code of Regulations, title 18, section (Regulation) 1698.5, *Audit Procedures*. The proposed regulation will implement, interpret, and make specific Revenue and Taxation Code section (section) 7053, which requires sellers, retailers, and consumers to maintain sales and use tax records in such form as the Board may require and section 7054, which authorizes the Board to examine records, property, and persons, and conduct investigations to verify the accuracy of returns and accurately ascertain sales and use tax liabilities.

A public hearing on the proposed adoption of Regulation 1698.5 was held in Room 121, 450 N Street, Sacramento, California, on March 23, 2010. No interested parties asked to speak at the public hearing or submitted written comments on the proposed amendments. However, the Board did authorize staff to make the grammatical and sufficiently related changes to the original text of proposed Regulation 1698.5, and referred Regulation 1698.5, to the fifteen-day file as described below.



## **Sufficiently Related Changes to the Original Proposed Text to Address the Office of Administrative Law's Concerns Regarding Information/Document Requests and Audit Findings Presentation Sheets**

Office of Administrative Law (OAL) staff performed a preliminary review of the original text of proposed Regulation 1698.5 and tentatively concluded that the Board is trying to incorporate the draft Information/Document Request (IDR) and Audit Findings Presentation Sheet (AFPS) templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005<sup>1</sup> into Regulation 1698.5, subdivision (a)(6) and (7), by reference under California Code of Regulations, title 1, section 20 (Rule 20) because the templates and the subdivision's text refers to IDRs and AFPSs as Board forms. Therefore, OAL staff contacted Board staff to express concerns that Board staff was not complying with the requirements of Rule 20 because the references to the forms did not include the dates the forms were adopted or issued and Board staff was not making the templates available to the public as part of the rulemaking documents for the proposed adoption of Regulation 1698.5.

Board staff responded to OAL staff's concerns and explained that the draft templates contained in exhibits 3 and 4 to Formal Issue Paper 09-005 have not been adopted or issued, the Board is not currently trying to incorporate the templates into Regulation 1698.5 by reference, and the Board does not need to comply with Rule 20. In addition, the Board's Legal Department discussed this matter with OAL's Legal Department and continues to believe that the templates the Sales and Use Tax Department will eventually implement for use in the IDR and AFPS processes will not need to be adopted as regulations because they will not impose any regulatory requirements on taxpayers or Board staff. However, to avoid any confusion and further clarify that the Board is not trying to incorporate IDR and AFPS forms into Regulation 1698.5 by reference in accordance with Rule 20, the Board's Legal Department requested authorization to:

- Change the original text of proposed Regulation 1698.5, subdivision (a)(6), to provide that "Board staff may issue an Information Document/Request (IDR) to request single or multiple documents, data, and other information from the taxpayer under audit," rather than refer to an IDR as a Board form; and
- Change the original text of proposed Regulation 1698.5, subdivision (a)(7), to provide that "An Audit Findings Presentation Sheet (AFPS) is used to present the staff's findings for each area of the audit as it is completed," rather than refer to an AFPS as a Board form.

Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to

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<sup>1</sup> For ease of reference, Formal Issue Paper 09-005, and the Notice of Rulemaking, Initial Statement of Reasons, and original proposed text of Regulation 1698.5 are available on the Board's Website at: [http://www.boe.ca.gov/regs/reg1698\\_5.htm](http://www.boe.ca.gov/regs/reg1698_5.htm).



make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

### **Sufficiently Related Changes to the Original Proposed Text to Address the Board's Taxpayers' Rights Advocate Office's Concerns**

On February 5, 2010, the Board's own Taxpayers' Rights Advocate (TRA) Office submitted written comments to the Board's regulations coordinator suggesting that the Board delete the phrase "and provide adequate resources to do so" and the word "federal" from the original text of proposed Regulation 1698.5, subdivision (b)(5)(B) and (C), respectively.<sup>2</sup> The Board's Sales and Use Tax Department and the Legal Department agreed with the TRA Office's comment that the phrase "and provide adequate resources to do so" should be deleted from subdivision (b)(5)(B) because the Board cannot require taxpayers to devote adequate resources to their audits and jointly requested the Board's authorization to make the sufficiently related change. In addition, the Sales and Use Tax Department and the Legal Department agreed that subdivision (b)(5)(C) should be revised to prohibit Board staff from requiring that taxpayers provide documents when the Board is prohibited by any applicable law, not just a "federal" law, from requiring that taxpayers do so and jointly requested the Board's authorization to change subdivision (b)(5)(C). Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

In addition, the TRA Office suggested that the Board delete the phrase "which is used to confirm the start of an audit or establish contact with the taxpayer" from subdivision (a)(6) of the original text of proposed Regulation 1698.5; and add a new subdivision (a)(2) to the original text of proposed Regulation 1698.5 to define the term "audit engagement letter" for purposes of the entire regulation and renumber the other paragraphs in subdivision (a) accordingly. During the public hearing on March 23, 2010, the Board agreed with the TRA Office that the changes were necessary to ensure that taxpayers did not confuse "audit engagement letters," IDRs, and AFPSs. Therefore, the Board authorized Board staff to make both sufficiently related changes to the original text of proposed Regulation 1698.5, as shown on the enclosed strikeout and underline version of the regulation, and directed staff to make the full text of the resulting regulation, with the changes clearly indicated, available to the public for at least 15 days

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<sup>2</sup> For ease of reference, the TRA Office's comments are attached to and responded to in the March 10, 2010, memorandum from the Board's Chief Counsel to the Board Members for consideration at the March 23, 2010, public hearing, which is available at [http://www.boe.ca.gov/meetings/pdf/F1\\_032310.pdf](http://www.boe.ca.gov/meetings/pdf/F1_032310.pdf).



before the Board's adoption in accordance with Government Code section 11346.8, subdivision (c)(2).

### **Grammatical Changes to the Original Proposed Text**

Furthermore, the Sales and Use Tax Department and Legal Department requested the Board's authorization to delete the word "the" before the reference to "AFPSs" in the original text of proposed Regulation 1698.5, subdivision (a)(7), to make the revised sentence grammatically correct; and the Board Members noticed that the word "the" was need before the word "taxpayer's" in the original text of proposed Regulation 1698.5, subdivision (b)(4)(K), to make the revised sentence grammatically correct. Therefore, the Board authorized Board staff to make both grammatical changes to the original text of proposed regulation 1698.5 in accordance with Government Code section 11346.8, subdivision (c)(1)

### **Necessity**

Finally, the Board discussed the necessity for proposed Regulation 1698.5 during the March 23, 2010, public hearing. The Board Chair indicated that the regulation is necessary to clearly establish taxpayers' and Board staff's responsibilities and duties during the audit process in order to ensure that Board staff completes audits in a timely and efficient manner with due regard to each taxpayer's rights, and to help taxpayers better understand and avoid confusion regarding the Board's audit process.

### **Additional Comments Regarding Changes**

Enclosed is a revised underscore and strikeout version of the text of proposed Regulation 1698.5 with the additional changes authorized on March 23, 2010, shown in double strikeout and double underline. In accordance with Government Code section 11346.8, subdivision (c), the revised version of the regulation is being placed in the rulemaking file and mailed to interested parties who commented orally or in writing, or who asked to be informed of such revisions. If you wish to review the rulemaking file, it is available for your inspection at the State Board of Equalization, 450 N Street, Sacramento, CA 95814.

The revised version of the text of proposed Regulation 1698.5 will be placed on the May 25, 2010, Board meeting agenda for the Board's consideration and potential adoption at 9:30 a.m., or as soon thereafter as the matter may be heard. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed regulation.

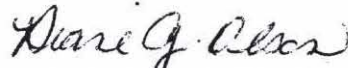
In addition, any interested person may also submit written comments regarding the Board's proposed adoption of the revised text of Regulation 1698.5. The written comment period closes at 9:30 a.m., or as soon thereafter as the matter

may be heard, on May 25, 2010. Written comments received by Mr. Rick Bennion, at the postal address, email address, or fax number provided below, prior to the close of the written comment period will be submitted to and considered by the Board before the Board decides whether to adopt the proposed regulation. Furthermore, any written comments received prior to the end of the written comment period must be responded to in the final statement of reasons required by Government Code section 11346.9.

Questions regarding the substance of the revised version of the proposed regulation should be directed to Bradley M. Heller, Tax, Counsel III (Specialist), by telephone at (916) 324-2657, by e-mail at [Bradley.Heller@boe.ca.gov](mailto:Bradley.Heller@boe.ca.gov), or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the May 25, 2010, Board meeting, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at [Richard.Bennion@boe.ca.gov](mailto:Richard.Bennion@boe.ca.gov), or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:81 | 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

Sincerely,



Diane G. Olson, Chief  
Board Proceedings Division

DGO:reb

Enclosures

## STATE BOARD OF EQUALIZATION

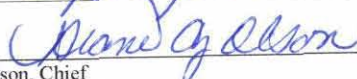


BOARD APPROVED

At the

5/25/2010

Board Meeting



Diane G. Olson, Chief  
Board Proceedings Division



**Revised Text of  
California Code of Regulations,  
Title 18,**

**Regulation 1698.5. Audit Procedures.**

**(a) DEFINITIONS.**

- (1) BOARD. For the purposes of this regulation, "Board" refers to the Board of Equalization.
- (2) AUDIT ENGAGEMENT LETTER. An audit engagement letter is correspondence used by Board staff to confirm the start of an audit or establish contact with the taxpayer.
- (23) PRE-AUDIT CONFERENCE. A meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff prior to the opening conference to discuss the availability and production of records, including electronic records. This meeting may occur several months before the opening conference with Board staff.
- (34) OPENING CONFERENCE. The first meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff to discuss how the audit will be conducted and to begin the field audit work.
- (45) STATUS CONFERENCES. Meetings between the taxpayer and/or the taxpayer's representative or designated employee and Board staff held throughout the audit to discuss audit issues and the progress of the audit.
- (56) EXIT CONFERENCE. The meeting between the taxpayer and/or the taxpayer's representative or designated employee and Board staff at the conclusion of the audit to discuss the audit findings.
- (67) INFORMATION/DOCUMENT REQUEST (IDR). A Board staff may issue an Information/Document Request (IDR) ~~Board form used~~ to request single or multiple documents, data, and other information from the taxpayer under audit. An IDR will be issued when the taxpayer fails to provide records in response to verbal requests. An audit engagement letter, ~~which is used to confirm the start of an audit or establish contact with the taxpayer,~~ is not an IDR.
- (78) AUDIT FINDINGS PRESENTATION SHEET (AFPS). An Audit Findings Presentation Sheet (AFPS) is ~~Board form~~ used to present the staff's findings for each area of the audit as it is completed. The audit working paper lead and subsidiary schedules are attached to the AFPSs.
- (89) RECORDS. For the purposes of this regulation, "records" includes all records, including electronic (machine-sensible) records, necessary to determine the correct tax liability under the Sales and Use Tax Law and all records necessary for the proper completion of the sales and use tax return as provided in Regulation 1698.
- (910) DAY. For the purposes of this regulation, "day" means calendar day.

**(b) GENERAL.**

The Board has a duty and an obligation to utilize its audit resources in the most effective and efficient manner possible. This regulation provides taxpayers and Board staff with the necessary procedures and guidance to facilitate the efficient and timely completion of an audit. The regulation also provides for



appropriate and timely communication between Board staff and the taxpayer of requests, agreements, and expectations related to an audit.

(1) The purpose of an audit is to efficiently determine whether or not the amount of tax has been reported correctly based on relevant tax statutes, regulations, and case law.

(2) The audit of a taxpayer's records shall be completed in sufficient time to permit the issuance of a Notice of Determination or Notice of Refund within the applicable statute of limitations. Audits of periods with potential liability shall be completed in sufficient time prior to the expiration of the statute of limitations to allow for the issuance of a determination, unless the taxpayer consents to extend the period by signing a waiver of limitation.

(3) Waiver of Limitation. A waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a Notice of Determination or Notice of Refund may be issued. Auditors shall request taxpayers sign a waiver of limitation when there is sufficient information to indicate that an understatement or overstatement exists, but there is insufficient time to complete the audit before the expiration of the statute of limitations. The auditor should also request a waiver be signed when a taxpayer requests a postponement before the audit begins or while an audit is in process. If the taxpayer declines to sign a waiver, the Board may issue a determination for the expiring period(s).

Supervisory approval of the circumstances which necessitated the request for the waiver will be documented in the audit before the waiver is presented to the taxpayer for signature. If the extension of the statute of limitations totals two years or more, approval by the District Principal Auditor will be documented in the audit before the waiver is presented to the taxpayer for signature.

(4) Duty of Board Staff.

(A) Apply and administer the relevant statutes and regulations fairly and consistently regardless of whether the audit results in a deficiency or refund of tax.

(B) Consider the materiality of an area being audited. Audit decisions are based on Board staff's determination of the amount of a potential adjustment balanced against the time required to audit the area and the duty to determine whether the correct amount of tax has been reported.

(C) Make information requests for the areas under audit as provided in Regulation 1698. The auditor will explain why records are being requested when asked to do so. The auditor will also work with the taxpayer to resolve difficulties a taxpayer has when responding to Board information requests, including the use of satisfactory alternative sources of information.

(D) Do not directly access the taxpayer's computer system if the taxpayer objects to such access, except in the case of a search warrant.

(E) Provide an audit plan to the taxpayer as provided in subdivision (c)(7) of this regulation.

(F) Adhere to the timelines set forth in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation, and provide the resources to do so.

(G) Keep the taxpayer apprised of the status of the audit through status conferences and AFPSs.

(H) Inform the taxpayer of the audit findings at the exit conference.

(I) Copy taxpayers (e.g., owners, partners, or corporate officers) on all Board correspondence related to the audit when the taxpayer has authorized another party to represent them.



(J) Safeguard taxpayers' records while examining them.

(K) Inform the taxpayer of the audit process, the taxpayer's rights, and appeal rights at the beginning of the audit.

(5) Duty of Taxpayers.

(A) Maintain records. Taxpayers have a duty to maintain the records and documents as required by Regulation 1698.

(B) Provide records requested by the Board pursuant to Regulation 1698; and adhere to the timelines in the original audit plan, or in the audit plan as amended pursuant to subdivision (c)(7) of this regulation; and provide adequate resources to do so.

(C) Make records available for photocopying or scanning. The Board may require the taxpayer to provide photocopies, or make available for photocopying or scanning, any specific documents requested by the Board that relate to questioned transaction(s) if necessary to determine the correct amount of tax, unless the Board is otherwise prohibited by federal law from requiring the specific documents.

(6) Application of Timeframes. The timeframes in this regulation are intended to provide for an orderly process that leads to a timely conclusion of an audit and are not to be used to prevent or limit a taxpayer's right to provide information.

(A) Some AFPSs can be responded to in less than or more than the timeframe specified in this regulation. The auditor has discretion to adjust this timeframe as warranted.

(B) Due dates for responses to IDRs and AFPSs shall be within the statute of limitations applicable to the audit. Auditors will consider late responses to IDRs and AFPSs, provided a period of the audit will not expire due to the statute of limitations.

(C) The timeframes provided in this regulation will have no effect on the statute of limitations as provided by the Revenue and Taxation Code or on any remedies available to the Board or rights of the taxpayer.

**(c) AUDITS.**

(1) Location of Audit. Audits generally take place at the location where the taxpayer's original books, records, and source documents relevant to the audit are maintained, which is usually the taxpayer's principal place of business. A request to conduct the audit at a different location shall include the reason(s) for the request. It is the taxpayer's responsibility to provide all requested records at that location. Requests will be granted unless Board staff determines the move will significantly delay the start or completion of the audit, or the Board does not have adequate resources available to conduct the audit at the requested location.

If the taxpayer operates out of a private residence, or has a small office or work environment that will not accommodate the auditor(s), Board staff may require the records be brought to a Board office or taxpayer's representative's office. If the audit is conducted at a Board office, the taxpayer will be provided a receipt for records.

(2) Multiple Requests by Taxpayers to Change the Location of an Audit. After an initial request to change the audit location has been granted by Board staff, any subsequent requests for location changes in the same audit period shall be made in writing and include the reason(s) for the request. These



subsequent requests will be considered on a case-by-case basis. Approval of these requests is at the discretion of Board staff.

(3) Site Visitations. Regardless of where the audit takes place, Board staff may visit the taxpayer's place of business to gain a better understanding of the business' operations (for example, a plant tour to understand a manufacturing process, or a visit to a restaurant to observe seating facilities or volume of business). Board staff may not visit secure areas, or areas that are regulated by the federal government where federal security clearance is necessary, unless authorized by the taxpayer. Board staff generally will visit on a normal workday of the Board during the Board's normal business hours.

(4) Time of the Audit. Board staff will generally schedule the field audit work for full days during normal workdays and business hours of the Board. The Board will schedule audits throughout the year, without regard to seasonal fluctuations in the businesses of taxpayers or their representatives. However, the Board will work with taxpayers and their representatives in scheduling the date and time of an audit to try to minimize any adverse effects.

Generally, the Board will not hold in abeyance the start of an audit pending the conclusion of an audit of prior periods or pending completion of an appeal of a prior audit currently in the Board's appeals process. In cases where a prior audit is under appeal and the audit for the subsequent periods is not held in abeyance, the Board will begin the current audit by examining areas that are not affected by the outcome of the appeal.

(5) Pre-audit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the pre-audit conference, whether or not the taxpayer has authorized another party to represent them. On audits where electronic records are involved, the Board's computer audit specialist shall participate in the pre-audit conference and the taxpayer's appropriate information technology staff shall be invited and encouraged to attend.

During the pre-audit conference, the items to be discussed include, but are not limited to: general audit procedures, availability and access of records, computer assisted audit procedures, relevant sampling issues, data transfer process, verification of data, security of data, timeframes for furnishing and reviewing records, and the name of the person designated to receive IDRs.

(6) Opening Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the opening conference, whether or not the taxpayer has authorized another party to represent them. During the opening conference, the items to be discussed include, but are not limited to: the scope of the audit, the audit plan, audit processes and procedures, claims for refund, estimated timeframes to complete the audit, the name of the person designated to receive IDRs, and the scheduling of future audit appointments. At the opening conference, the auditor shall provide in writing, the name and telephone number of the audit supervisor, and any Board staff assigned to the audit team.

(7) Audit Plan. All audits must be guided by an organized plan. The audit plan documents the areas under audit, the audit procedures, and the estimated timeframes to complete the audit. A carefully thought out, but flexible audit plan requires advance planning and a proper overview of the assignment as a whole. To facilitate the timely and efficient completion of an audit, Board staff shall develop an audit plan that strives for the completion of the audit within a two-year timeframe commencing with the date of the opening conference and ending with the date of the exit conference. Most audits will be completed in a much shorter timeframe and others may require a period beyond two years. Nothing in this subdivision shall be construed to extend the completion of an audit to two years when it can be completed in a shorter timeframe, nor limit the completion of an audit to two years when a longer timeframe is warranted.

An audit plan is required on all audits. The audit plan shall be discussed with, and a copy provided to, the taxpayer at the opening conference, or when it is necessary for the auditor to first review the taxpayer's



records, within 30 days from the opening conference. The audit plan should be signed by the auditor and either the taxpayer or the taxpayer's representative to show a commitment by both parties that the audit will be conducted as described in the audit plan to allow for the timely completion of the audit. The audit plan is considered a guideline for conducting the audit and may be amended throughout the audit process as warranted. If the original audit plan is amended, the auditor shall provide the taxpayer with a copy of the amended plan.

(8) Status Conferences. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend status conferences, whether or not the taxpayer has authorized another party to represent them. Status conferences should be held throughout the audit to discuss the status of the audit, IDRs and AFPSs, and to ensure the audit is on track for completion within the estimated timeframes as outlined in the audit plan.

(9) Record Requests.

(A) Verbal Requests. Before auditors proceed with the IDR process, taxpayers shall be allowed to comply with verbal requests for records. When Board staff is unable to make verbal contact with the taxpayer, the auditor may proceed directly with the IDR process. The auditor has the discretion to determine response times for verbal requests.

When records are not provided by the taxpayer in response to verbal requests for information as required by Regulation 1698 and subdivision (b)(5)(B) of this regulation, the auditor may proceed to the IDR process unless doing so results in a period of the audit expiring under the statute of limitations. If a period of the audit will expire, the Board may issue a determination for the expiring period(s).

(B) IDR Process. The IDR process includes the issuance of an initial IDR, a second IDR, and a formal notice and demand to furnish information.

1. Taxpayers will be allowed 30 days to respond to the initial IDR measured from the date the IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs. Any response other than full compliance with the IDR shall be reviewed by the District Principal Auditor who shall determine the course of action to be taken in response to any issues raised by the taxpayer.

2. Taxpayers will be allowed 15 days to provide records in response to the second IDR requesting the same records as the initial IDR. This date shall be measured from the date the second IDR is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

3. Within 30 days of the taxpayer providing records in response to an IDR, the auditor will notify the taxpayer in writing if the documents provided are sufficient, if additional information is needed, or if the auditor requires additional time to determine the sufficiency of the records.

4. A formal notice and demand to furnish information shall be issued upon the taxpayer's failure to furnish the requested records in response to the second IDR requesting the same records. The taxpayer will have 15 days to provide records in response to the notice and demand to furnish information before Board staff may issue a subpoena for those records or issue a determination based on an estimate, unless doing so results in a period of the audit expiring under the statute of limitations. This date shall be measured from the date the notice and demand is delivered or mailed to the taxpayer and the person designated by the taxpayer at the pre-audit or opening conference to receive IDRs.

(10) Audit Findings Presentation Sheet (AFPS). An AFPS should be used during the course of the audit as soon as each area of the audit is completed to provide the taxpayer with the proposed audit



findings. Taxpayers will be asked to indicate whether they agree or disagree with the proposed findings. The taxpayer will be given an opportunity to provide additional information and documents to rebut the audit findings, generally within 30 days of the date the AFPS was delivered or mailed to the taxpayer, or the taxpayer's representative, or as otherwise provided for in subdivision (b)(6) of this regulation. Agreement to the audit findings does not preclude the taxpayer from appealing the issue(s) at a later date.

As a general rule, within 30 days of the taxpayer providing additional information in response to an AFPS, the auditor will notify the taxpayer if adjustment to the audit is warranted based on the information provided.

(11) Exit Conference. Taxpayers (e.g., owners, partners, or corporate officers) shall be invited and encouraged to attend the exit conference, whether or not the taxpayer has authorized another party to represent them. During an exit conference, the items discussed include, but are not limited to: an explanation of the audit findings, the audit schedules, the review process, how to prepay a liability, and the Board's appeal procedures.

The auditor shall provide the taxpayer and the taxpayer's representative with a complete copy of the audit working papers, including verification comments, which explain the basis for the audit findings.

(A) Generally, taxpayers shall be given 30 days from the date of the exit conference to indicate whether they agree or disagree with the audit findings, unless doing so results in a period of the audit expiring under the statute of limitations. If the taxpayer disagrees with the audit findings, they may provide additional information within this 30 days for the auditor to consider. The auditor may adjust the audit findings if warranted based on the information provided.

(B) The audit findings are subject to additional review by Board staff to ensure that the audit findings are consistent with the Sales and Use Tax laws and regulations, and Board policies, practices, and procedures. A copy of any audit working papers adjusted as a result of the review process shall be provided to the taxpayer.

Note: Authority cited: Section 7051, Revenue and Taxation Code. Reference: Sections 7053 and 7054, Revenue and Taxation Code; and California Code of Regulations, title 18, section 1698.



BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION

450 N Street, Room 121

Sacramento, California

REPORTER'S TRANSCRIPT

MAY 26, 2010

ITEM J1

CHIEF COUNSEL MATTERS

RULEMAKING

Reported by: Beverly D. Toms

No. CSR 1662

## P R E S E N T

For the Board  
of Equalization:

Betty Yee  
Chair

Jerome E. Horton  
Vice-Chair

Barbara Alby  
Acting Member

Michelle Steel  
Member

Marcy Jo Mandel  
Appearing for John  
Chiang, State Controller  
(per Government Code  
Section 7.9)

Joann Richmond  
Property Tax Appeals Analyst  
Board Proceedings Division

Board of Equalization  
Staff:

Bradley Heller  
Tax Counsel

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Sacramento, California

May 26, 2010

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MS. RICHMOND: Our next item is Chief Counsel Matters, Rulemaking. Proposed Regulation 1698.5, Audit Procedures.

Mr. Heller will introduce this case.

MS. YEE: Thank you. Good afternoon, Mr. Heller.

MR. HELLER: Good afternoon, Madam Chair, Members of the Board. I'm here on behalf of the staff to request that the Board adopt proposed Regulation 1698.5, Audit Procedures, with the changes the Board approved in March.

MR. HORTON: So moved.

MS. YEE: Okay, motion by Mr. Horton. Is there a second?

MS. MANDEL: Second.

MS. YEE: Second by Ms. Mandel.

Discussion?

MS. STEEL: I --

MS. YEE: Ms. Steel.

MS. STEEL: Madam Chair.

MS. YEE: Yes.

MS. STEEL: I think this is entirely unnecessary for this to make regulations. It's more suited for the Audit Manual and this one shows that overly-burdensom regulations to the business environment

1 in the State. So I still cannot go for it.

2 MS. ALBY: I cannot see --

3 MS. YEE: Okay. Thank you, Ms. Steel.

4 Other comments?

5 MS. STEEL: It's J1.

6 MS. ALBY: I know, I'm looking. I can't find  
7 it.

8 MS. YEE: This is J1.

9 MS. STEEL: It's the audit manual.

10 MS. ALBY: You know --

11 MS. STEEL: Regulation.

12 MS. ALBY: Go ahead, don't wait for me, I'll --  
13 I'll find it.

14 MS. YEE: Okay. We may have comments.

15 MS. ALBY: Here we go. Got it.

16 Yup, I'm with you.

17 MS. YEE: Any comments?

18 MS. ALBY: (Inaudible).

19 MS. YEE: Okay. All right, motion by Mr.  
20 Horton, second by Ms. Mandel to adopt the proposed  
21 regulation as amended.

22 Please call the roll.

23 MS. RICHMOND: Madam Chair.

24 MS. YEE: Aye.

25 MS. RICHMOND: Ms. Alby.

26 MS. ALBY: No.

27 MS. RICHMOND: Ms. Steel.

28 MS. STEEL: No.



1 MS. RICHMOND: Mr. Horton.

2 MR. HORTON: Aye.

3 MS. RICHMOND: Ms. Mandel.

4 MS. MANDEL: Aye.

5 MS. RICHMOND: Motion carries.

6 MS. YEE: Thank you. Thank you, Mr. Heller.

7 MR. HELLER: Thank you.

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## REPORTER'S CERTIFICATE

State of California     )  
                                  )   ss  
County of Sacramento    )

I, BEVERLY D. TOMS, Hearing Reporter for the California State Board of Equalization certify that on May 26, 2010 I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding 5 pages constitute a complete and accurate transcription of the shorthand writing.

Dated: June 2, 2010 .



*Beverly D Toms*

BEVERLY D. TOMS

Hearing Reporter